Supreme Court, U.S.
FILED
JUL 30 2007
OFFICE OF THE CLERK

No. 06-1287

IN THE

Supreme Court of the United States

CSX TRANSPORTATION, INC.,

Petitioner,

v.

STATE BOARD OF EQUALIZATION of the State of Georgia; Bart L. Graham, as Commissioner of Revenue of the State of Georgia; Russell W. Hinton, as State Auditor of the State of Georgia; and Gena L. Abraham, as Director of the Georgia State Properties Commission,

Respondents.

On a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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U.S. DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA (ATLANTA)

CIVIL DOCKET FOR CASE #: 1:02-CV-02634-CAP

CSX TRANSPORTATION,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF GEORGIA, et al.,

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
09/26/2002	01	COMPLAINT filed. Consent form to proceed before U.S. magistrate and pretrial instructions given to attorney. FILING FEE $150.00 RECEIPT # 494840 (aet) (Entered: 09/26/2002)
		* * * *
10/16/2002	17	ANSWER by defendants to complaint [1-1]. Discovery ends 3/15/03. (slc) (Entered: 10/17/2002)
		* * * *
12/17/2004	67	Proposed Pretrial Order by CSX Transportation, Inc., State Board of Equalization, Jerry Jackson, Russell W. Hinton, Ray J. Crawford. (Attachments: # 1 attachments part 1 # 2 attachments part 2 # 3 attachments part 3) (als) (Entered: 12/30/2004)
		* * * *

DATE	NO.	PROCEEDINGS
05/13/2005	105	TRANSCRIPT of Proceedings held on 5/17/2005 before Judge Charles A. Pannell, Jr., Court Reporter: Martha Frutchey. (yrm) Modified on 12/7/2005 to correct file date (fem). (Entered: 06/14/2005)
05/13/2005	106	TRANSCRIPT of Proceedings held on 5/18/2005 before Judge Charles A. Pannell, Jr.. Court Reporter: Martha Frutchey. (yrm) Modified on 12/7/2005 to correct file date (fem). (Entered: 06/14/2005)
05/13/2005	107	TRANSCRIPT of Proceedings held on 5/19/2005 before Judge Charles A. Pannell, Jr.. Court Reporter: Martha Frutchey. (yrm) Modified on 12/7/2005 to correct file date (fem). (Entered: 06/14/2005)
05/13/2005	108	TRANSCRIPT of Proceedings held on 5/20/2005 before Judge Charles A. Pannell, Jr., Court Reporter: Martha Frutchey. (yrm) Modified on 12/7/2005 to correct file date (fem). (Entered: 06/14/2005)
05/13/2005	109	TRANSCRIPT of Proceedings held on 5/23/2005 before Judge Charles A. Pannell, Jr.. Court Reporter: Martha Frutchey. (yrm) Modified on 12/7/2005 to correct file date (fem). (Entered: 06/14/2005)

* * * *

DATE	NO.	PROCEEDINGS
09/29/2005	118	ORDER – The Court concludes that the defendants have not discriminated against CSXT in violation of 49 U.S.C. 11501 (b)(4). The Court also holds that the true market unit value of CSXT for the tax year 2002 was $7,726,293,350. The true market value of CSXT's taxable rail transportation property in Georgia for the tax year 2002 was $509,560,171. The defendants, therefore, have not discriminated against CSXT in violation of 49 U.S.C. 11501(b)(1) because the ratio of assessed value to true market value of CSXT's property does not exceed the jurisdictional threshold set out in the 4-R of 42 %. Thus, CSXT is not entitled to relief under the 4-R Act for the tax year 2002. The clerk is DIRECTED to close this file and issue judgement for the defendants in accordance with this ORDER. Signed by Judge Charles A. Pannell on 9/29/05. (dcs) (Entered: 09/29/2005)
09/29/2005	119	CLERK'S JUDGMENT in favor of Defendant against Plaintiff. (dcs) – Please refer to http://www.ca11uscourts.gov to obtain an appeals jurisdiction checklist (Entered: 09/29/2005)
09/29/2005		Civil Case Terminated. (dcs) (Entered: 09/29/2005)

DATE	NO.	PROCEEDINGS
10/26/2005	120	NOTICE OF APPEAL as to 118 Order, 119 Clerk's Judgment by CSX Transportation, Inc. Filing fee $255, receipt number 543364. Transcript Order Form due on 11/9/2005 (fem) (Entered: 10/28/2005)
		* * * *
02/21/2007	140	Certified copy of JUDGMENT of USCA AFFIRMING the decision of the District Court re: 120 Notice of Appeal filed by CSX Transportation, Inc., Case Appealed to USCA Case Number 06-16000. (fem) (Entered: 02/22/2007)

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 05-16000-CC

CSX TRANSPORTATION, INC.,
Plaintiff-Appellant,

versus

STATE BOARD OF EQUALIZATION, of the State of Georgia, JERRY JACKSON, as Commissioner of Revenue of the State of Georgia, RUSSELL W. HINTON, as State Auditor of the State of Georgia, RAY J. CRAWFORD, as Director of the Georgia State Properties Commission,
Defendants-Appellees

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
		* * * *
12/19/2006		Judgment Entered
12/19/2006		OPINIA (Notice of issuance of opinion) issued. Costs taxed against the Appellant. c:Charles A. Pannell, Jr.; c:James W. McBride; c:Milo S. Cogan; c:Peter J. Crossett; c: Stephen D. Goodwin; c:Timothy H. Kratz; c: Warren R. Calvert
12/19/2006		Opinion Issued
		* * * *

DATE	NO.	PROCEEDINGS
02/17/2007		The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, the Petition(s) for Rehearing En Banc are DENIED.
02/12/2007		REHG1 (Letter enclosing order) issued. c:Betty Jo Christian; c:James W. McBride; c:Milo S. Cogan; c:Peter J. Crossett; c:Stephen D. Goodwin; c: Timothy H. Kratz; c: Warren R. Calvert
		* * * *
02/20/2007		CASE CLOSED-Mandate Issued
02/20/2007		Mandate Issued
02/20/2007		MDT1 (Letter issuing mandate) issued. To: James N. Hatten; c: Betty Jo Christian; c:James W. McBride; c:Milo S. Cogan; c:Peter J. Crossett; c:Stephen D. Goodwin; C: Timothy H. Kratz; c: Warren R. Calvert
03/26/2007		Notice of Filing Certiorari: (SC #06-1287)
06/04/2007		Certiorari Granted: (SC#06-1287)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

[Filed SEP. 26, 2002]

CIVIL ACTION FILE NO.: 1 02-CV-2634

CSX TRANSPORTATION, INC.
Plaintiff,

v.

THE STATE BOARD OF EQUALIZATION OF THE STATE OF GEORGIA; JERRY JACKSON, as Commissioner of Revenue of the State of Georgia; RUSSELL W. HINTON, as State Auditor of the State of Georgia; and RAY J. CRAWFORD, as Director of the Georgia State Properties Commission
Defendants.

VERIFIED COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF

1. This is a civil action under 49 U.S.C. § 11501 seeking injunctive and declaratory relief with respect to property taxes that are imposed by the State of Georgia upon plaintiff railroad. As appears more fully herein, plaintiff contends that such taxes discriminate against plaintiff railroad and violate 49 U.S.C. § 11501.

JURISDICTION

2. Jurisdiction of this Court is based upon the following grounds:

(a) Section 306 of Pub.L.No. 94-210, 90 Stat. 54 (Feb. 5, 1976), now codified as 49 U.S.C. § 11501 (referred to herein as "Section 306"), which confers jurisdiction upon district courts of the United States (notwith-

standing 28 U.S.C. § 1341 and without regard to amount in controversy or citizenship of the parties) to prevent a state, subdivision of a state, or any authority of a state or a subdivision of a state, from imposing any tax which results in discriminatory treatment of a common carrier by railroad;

(b) 28 U.S.C. § 1337: As more fully appears herein, this action arises under an Act of Congress regulating commerce; and

(c) 28 U.S.C. § 1331: As more fully appears herein, this action arises under United States Constitution Article I, § 8, Cl.3 (Commerce Clause) and the Fourteenth Amendment to the United States Constitution and presents a federal question.

VENUE

3. The defendants reside in this district, and the claim arises in this district, and thus proper venue lies in this Court under 28 U.S.C. § 1391(b).

PARTIES

4. Plaintiff, referred to herein as "CSXT," is CSX Transportation, Inc.. CSXT is a Virginia corporation with its principal place of business in Jacksonville, Florida, and is an interstate common carrier by railroad. CSXT is duly qualified to do business in the State of Georgia and owns property subject to ad valorem taxation in the State of Georgia.

5. Defendant State Board of Equalization (hereafter sometimes referred to as "the Board") is an agency of the State of Georgia.

6. Defendant Jerry Jackson is the Commissioner of Revenue of the State of Georgia, a member of the Board, and is named as a defendant in his official capacity.

7. Defendant Russell Hinton is the State Auditor of the State of Georgia, a member of the Board, and is named as a defendant in his official capacity

8. Defendant Ray J. Crawford is the Director of the Georgia State Properties Commission, a member of the Board, and is named as a defendant in his official capacity.

AD VALOREM TAXATION IN GEORGIA

9. Pursuant to O.C.G.A. § 48-5-6, all property subject to taxation in Georgia is to be appraised for assessment purposes by the Georgia Department of Revenue ("DOR") at its fair market value.

10. After all non-exempt property in Georgia is purportedly "appraised" at its fair market value, an assessment ratio of 40% is applied to the appraised value to derive the "assessed value" of all property. *See* O.C.G.A. § 48-5-7. It is the "assessed" value against which the property tax rate is applied and taxes are levied and collected.

11. Pursuant to O.C.G.A. § 48-2-18, the Board annually determines and approves a proposed assessment of railroad property, including that of CSXT.

12. Upon information and belief, CSXT alleges that the Board shall issue its proposed assessment in early October 2002. The issuance of a proposed assessment and the notification of such proposed assessments to the counties is the last act required of state officials in the assessment of railroad operating property.

13. Within 30 days after receipt of the proposed assessment, the county board of tax assessors in each county in which CSXT owns property shall make the final assessment. *See* O.C.G.A. § 48-2-18(d). Upon information and belief, CSXT alleges that, as a routine practice, the various county boards of tax assessors adopt the Board's proposed assessments and levy and collect taxes based on the Board's

proposed assessments. Indeed, for the 2001 tax year no county issued a final assessment for CSXT that differed from the proposed assessments issued by the Board.

SECTION 306

14. Section 306 declares that any state tax which results in discriminatory treatment of a common carrier by railroad subject to the jurisdiction of the Interstate Commerce Act constitutes an unreasonable and unjust discrimination against, and an undue burden upon, interstate commerce. Section 306, a copy of which is attached as Exhibit "A", states:

> "[A]ny action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:
>
> "(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.
>
> (b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).
>
> (c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.

(d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this part."

15. Section 306(3)(a) defines "assessment" as "valuation for purposes of a property tax levied by any taxing district."

16. Section 306(3)(d) defines "transportation property" to mean "transportation property, as defined in regulations of the [Interstate Commerce] Commission, which is owned or used by a common carrier by railroad subject to this part or which is owned by the National Railroad Passenger Corporation."

17. Section 306(3)(c) defines "commercial and industrial property" to mean "all property, real or personal, other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and which is subject to a property tax levy."

18. CSXT is a common carrier by railroad and is entitled to the protection of Section 306. All of CSXT's property which is the subject of this action is "transportation property" within the meaning of Section 306.

PLAINTIFF'S SECTION 306 CLAIMS

19. Section 306(1)(a) prohibits the assessment of transportation property at a higher ratio to true market value than the ratio of assessed value to true market value of all other commercial and industrial property.

20. "True Market Value" as utilized in Section 306 means fair market value as that term is traditionally defined, and is synonymous with "fair market value" as used in the Georgia statutes.

21. Upon information and belief, CSXT alleges that, after application of the 40% ratio required by O.C.G.A. § 48-5-7, the ratio of assessed value to true market value of all other

commercial and industrial property in Georgia for the 2002 tax year is no more than 40%.

22. CSXT also alleges that since 1996 the property tax on intangible personal property has been repealed in Georgia and that no other locally assessed commercial and industrial taxpayer (other than certain financial institutions) pay tax on intangible personal property.

23. Upon information and belief, CSXT alleges that the Board intends to issue a proposed assessment for CSXT for the tax year 2002 based on the DOR's determination that the system-wide appraised value of CSXT is no lower than $8.2 billion, while the actual true market value of CSXT's taxable operating property is no more than $6 billion.

24. As a result, after application of the 40% ratio required by O.C.G.A. § 48-5-7, the ratio of the assessed value to true market value of CSXT's taxable railroad operating property will be no less than 54.7% and will exceed the ratio applicable to other commercial and industrial real property by more than 5%, in direct contravention of the prohibitions of Section 306(1)(a).

25. Such an excessive and discriminatory assessment results from erroneous appraisal practices by the DOR and the fact that the valuation determined by the DOR contains substantial value attributable to intangible personal property, while locally assessed taxpayers are not subject to tax on intangible personal property.

26. The assessment, levy, or collection of any property tax on the excessive portion of CSXT's valuation will violate Section 306. Unless the defendants, their agents and those acting in concert with them are enjoined and restrained by this Court from assessing, levying, and collecting the taxes based upon these illegal proposed assessments, the plaintiff will be obligated to pay such illegal taxes wrongfully assessed in violation of Section 306.

27. Plaintiff is entitled to a declaratory judgment, order, and decree of this Court determining the proper ratio of assessed value to true market value that may be legally applied to plaintiff's transportation property for the 2002 tax year and an injunction and temporary restraining order enjoining the defendants, their agents and those acting in concert with them, from assessing, levying, or collecting taxes in excess thereof. Plaintiff should not be required to pay such taxes until the lawful taxes are determined.

WHEREFORE, plaintiff prays that this Court:

(a) Determine and decree the proper ratio of assessed value to true market value applied to plaintiff's transportation property above which the defendants are prohibited from assessing plaintiff's transportation property; that this Court issue all necessary and proper prohibitory and mandatory restraining orders and injunctions to effectuate the findings of this Court; and for such other relief as will effectuate the provisions of Section 306 and grant plaintiff full relief; and

(b) Render a declaratory judgment pursuant to 28 U.S.C. § 2201 declaring that the excessive assessment of the plaintiff's rail transportation property, and the imposition, levy, or collection of any taxes based on that illegal assessment, violate Section 306 and constitute an undue and impermissible burden upon interstate commerce; and

(c) Issue a temporary restraining order, and preliminary and permanent injunction to restrain the defendants, their agents, and those acting in concert and participation with them, from assessing, levying, collecting, or imposing any tax on the plaintiff's property based on an assessment in excess of the ratio of assessed value to true market value of other commercial and industrial property; and

(d) Set a date for hearing the plaintiff's application for a temporary restraining order and a preliminary injunction; and

(e) Grant such other equitable relief to which the plaintiff is entitled.

CERTIFICATION

Counsel certifies that the foregoing complies with the font and point selections approved by the Court.

Respectfully submitted,

/s/ Timothy H. Kratz
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VERIFICATION

STATE OF GEORGIA
COUNTY OF FULTON

Kerry G. Carnahan, having first been duly sworn, states that he is the Director—Property Taxes for CSXT Transportation, Inc.; that he has read the foregoing Complaint; that the facts stated therein are true to the best of his knowledge, information and belief.

/s/ Kerry G. Carnahan
KERRY G. CARNAHAN

SWORN AND SUBSCRIBED before me
This 25th day September, 2002.

/s/ Toni A. Clark
Notary Public
My Commission Expires:

May 27, 2003

Section 306 of the
Railroad Revitalization and Regulatory Reform Act of 1976
Pub. L. No. 94-210, 90 Stat. 54 (Feb. 5, 1976)

(1) Notwithstanding the provisions of section 202(b), any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:

(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

(b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).

(c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.

(d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this part.

(2) Notwithstanding any provision of section 1341 of title 28, United States Code, or of the constitution or laws of any State, the district courts of the United States shall have jurisdiction, without regard to amount in controversy or citizen-

ship of the parties, to grant such mandatory or prohibitive injunctive relief, interim equitable relief, and declaratory judgments as may be necessary to prevent, restrain, or terminate any acts in violation of this section, except that—

(a) such jurisdiction shall not be exclusive of the jurisdiction which any Federal of State court may have in the absence of this subsection;

(b) the provisions of this section shall not become effective until 3 years after the date of enactment of this section;

(c) no relief may be granted under this section unless the ratio of assessed value to true market value, with respect to transportation property, exceeds by at least 5 per centum the ratio of assessed value to true market value, with respect to all other commercial and industrial property in the same assessment jurisdiction;

(d) the burden of proof with respect to the determination of assessed value and true market value shall be that declared by the applicable State law; and

(e) in the event that the ratio of the assessed value of all other commercial and industrial property in the assessment jurisdiction to the true market value of all such other commercial and industrial property cannot be established through the random-sampling method known as a sales assessment ratio study (conducted in accordance with statistical principles applicable to such studies) to the satisfaction of the court hearing the complaint that transportation property has been or is being assessed or taxed in contravention of the provisions of this section, then the court shall hold unlawful an assessment of such transportation property at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other property in the assessment jurisdiction in which is included

such taxing district and subject to a property tax levy bears to the true market value of all such other property, and the collection of any ad valorem property tax on such transportation property at a tax rate higher than the tax rate generally applicable to taxable property in the taxing district.

(3) As used in this section, the term—

(a) "assessment" means valuation for purposes of a property tax levied by any taxing district;

(b) "assessment jurisdiction" means a geographical area, such as a State or a county, city, township, or special purpose district within such State which is a unit for purposes of determining the assessed value of property for ad valorem taxation;

(c) "commercial and industrial property" or "all other commercial and industrial property" means all property, real or personal, other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and which is subject to a property tax levy; and

(d) "transportation property" means transportation property, as defined in regulations of the Commission, which is owned or used by a common carrier by railroad subject to this part or which is owned by the National Railroad Passenger Corporation.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CIVIL ACTION FILE NO: 1:02-CV-2634CAP

CSX TRANSPORTATION, INC.

Plaintiff,

v.

THE STATE BOARD OF EQUALIZATION OF THE STATE OF GEORGIA; JERRY JACKSON, as Commissioner of Revenue of the State of Georgia; RUSSELL W. HINTON, as State Auditor of the State of Georgia; and RAY J. CRAWFORD, as Director of the Georgia State Properties Commission

Defendants.

ANSWER OF DEFENDANTS

Come now Defendants State Board of Equalization of the State of Georgia ("the Board"), T. Jerry Jackson, in his official capacity as Commissioner of Revenue of the State of Georgia and Chairman and member of the Board, Russell W. Hinton, in his official capacity as State Auditor of the State of Georgia and member of the Board, and Ray J. Crawford, in his official capacity as Director of the Georgia State Properties Commission and member of the Board, and answer and defend the Verified Complaint For Injunctive And Declaratory Relief ("the Complaint") in the above styled case as follows:

FIRST DEFENSE

The Complaint fails to state a claim upon which relief may be granted against the Defendants.

SECOND DEFENSE

The relief sought in the Complaint is barred by the Eleventh Amendment, sovereign immunity, and/or principles of comity.

THIRD DEFENSE

The Court lacks subject matter jurisdiction.

FOURTH DEFENSE

The Complaint fails to name as defendants one or more indispensable parties.

FIFTH DEFENSE

Defendants respond to the individual paragraphs of the Complaint as follows:

1.

Admit that this is a civil action under 49 U.S.C. § 11501 seeking injunctive and declaratory relief with respect to property taxes that are imposed upon the plaintiff; admit that plaintiff contends that such taxes discriminate against it and violate 49 U.S.C. § 11501; deny the remaining allegations of paragraph 1 of the Complaint.

2.

Admit that plaintiff asserts that jurisdiction exists by virtue of the federal statutes referred to in paragraph 2 of the Complaint; state that such statutes speak for themselves; state that the Complaint is barred by the Eleventh Amendment, sovereign immunity, and/or principles of comity; deny that this Court has subject matter jurisdiction; deny the remaining allegations of paragraph 2 of the Complaint.

3 through 8, inclusive.

Admit the allegations of paragraphs 3 through 8, inclusive, of the Complaint.

9.

States that O.C.G.A. § 48-5-6 speaks for itself; deny that all property subject to ad valorem taxation in Georgia is appraised by the Georgia Department of Revenue; deny the remaining allegations of paragraph 9 of the Complaint.

10.

State that paragraph 10 of the Complaint consists of legal assertions rather than factual allegations and therefore requires no response; state further that O.C.G.A. § 48-5-7 speaks for itself.

11.

Admit that the Board annually examines and approves the digest of proposed assessments of railroad companies' property, including that of the plaintiff, prepared by the Property Tax Division of the Georgia Department of Revenue; admit that the Board's duties and responsibilities in that regard are set forth in O.C.G.A. § 48-2-18; deny the remaining allegations of paragraph 11 of the Complaint.

12.

Deny the allegations of paragraph 12 of the Complaint.

13.

State that O.C.G.A. § 48-2-18(d) speaks for itself; admit that county boards of tax assessors often adopt proposed assessments approved by the Board and levy and collect taxes based on the same valuations; deny the last sentence of paragraph 13 of the Complaint for lack of information or knowledge sufficient to form a belief as to the truth thereof; deny the remaining allegations of paragraph 13 of the Complaint.

14 through 17, inclusive.

State that Section 306 of Pub. L. No. 94-210 speaks for itself.

18.

Deny that the plaintiff is entitled to any relief; admit that plaintiff is a common carrier by railroad; deny the remaining allegations of paragraph 18 of the Complaint for lack of information or knowledge sufficient to form a belief as to the truth thereof.

19.

State that Section 306 of Pub. L. No. 94-210 speaks for itself.

20.

State that paragraph 20 of the Complaint consists of legal assertions rather than factual allegations and therefore requires no response.

21.

Deny the allegations of paragraph 21 of the Complaint for lack of information or knowledge sufficient to form a belief as the truth thereof.

22.

Deny the allegations of paragraph 22 of the Complaint.

23.

State that the Board has not yet been presented with the proposed assessment of plaintiff for the 2002 tax year prepared by the Property Tax Division of the Georgia Department of Revenue; admit that the Property Tax Division has determined that the plaintiff's system-wide fair market value is no lower than $8.2 billion; deny the remaining allegations of paragraph 23 of the Complaint.

23

24 through 27, inclusive.

Deny the allegations of paragraphs 24 through 27, inclusive, of the Complaint.

28.

Deny each and every allegation of the Complaint not hereinbefore specifically admitted, qualified, or denied,

29.

Deny that the plaintiff is entitled to any of the requested relief.

WHEREFORE, having fully answered, the Defendants pray that the Court:

(1) Dismiss the Complaint or enter judgment thereon in favor of Defendants and against the plaintiff; and

(2) Grant such other and further relief as it deems proper and just under the circumstances.

CERTIFICATION

Counsel certifies that the foregoing has been prepared using one of the font and point selections approved in LR 5.1B, NDGa.

This 16th day of October, 2002.

THURBERT E. BAKER 033887
Attorney General

DANIEL M. FORMBY 269350
Deputy Attorney General

/s/ Warren R. Calvert
WARREN R. CALVERT 105341
Senior Assistant Attorney General

PLEASE ADDRESS ALL
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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

[Filed DEC. 17, 2004]

CIVIL ACTION FILE NO 1:02-CV-2634CAP

[Conference is Requested]

CSX TRANSPORTATION, INC.,
Plaintiff,

VS.

THE STATE BOARD OF EQUALIZATION OF THE STATE OF GEORGIA; BART L. GRAHAM as Commissioner of Revenue of the State of Georgia; RUSSELL W. HINTON, as State Auditor of the State of Georgia and RAY J. CRAWFORD, as Director of the Georgia State Properties Commission
Defendants.

JOINT PRE-TRIAL ORDER

* * * *

ATTACHMENT E TO PRETRIAL ORDER
STIPULATED FACTS

1. CSX Transportation, Inc. ("CSXT") is an interstate carrier by rail that operates in more than 71 counties in the state of Georgia.

2. CSXT, the taxpayer in this case, is a wholly-owned subsidiary of CSX Corporation.

3. The defendants are the State Board of Equalization and its individual members, including Bart L. Graham as State Commissioner of Revenue.

4. The appraised and assessed values of most property in Georgia is determined by local county boards of assessors. The parties refer to this property as "locally-assessed" property. Pursuant to O.C.G.A. § 48-5-6, most locally-assessed property subject to taxation in Georgia is to be appraised for assessment purposes at its fair market value. After any such non-exempt locally-assessed property in Georgia is "appraised" at its fair market value, an assessment ratio of 40% is applied to the appraised value to derive the "assessed value". *See* O.C.G.A. § 48-5-7. It is the "assessed" value against which the property tax is levied and collected.

5. Companies classified in Georgia as "public utilities" are commonly referred to as "centrally-assessed" taxpayers. Centrally-assessed taxpayers include railroads, investor-owned electric utilities, investor-owned telephone companies, pipeline companies, and gas distribution companies. The State Revenue Commissioner issues proposed assessments of the operating and non-operating property of public utilities.

6. The Property Tax Division of the Georgia Department of Revenue annually prepares a proposed assessment of the Plaintiff's railroad transportation operating properties for each and every Georgia county and municipality in which Plaintiff's taxable property is located.

7. In valuing the Plaintiff's railroad transportation operating property for 2002 ad valorem tax purposes, the Department used the unit rule method. The parties agree that the unit rule method is appropriate under Georgia law.

8. Pursuant to the unit rule method the Department first determined the value of the Plaintiff's railroad as an entire operating system irrespective of where the operating property is located and without functional or geographic division of the whole into its component parts.

9. For purposes of the proposed assessment issued to CSXT for the 2002 tax year, the Department determined that

the fair market value on a system unit basis for CSXT was no less than $8.2 billion as of January 1, 2002.

10. The Department estimated a working capital adjustment of $400 million and deducted that from the unit value estimate to eliminate the effect of certain intangible assets.

11. The Department allocated the adjusted unit value estimate of $7.8 billion to the State of Georgia by using the percentage of Georgia road miles to system road miles. For the tax year 2002 the percentage so applied equaled 7.194059%, resulting in an allocated value of $561,136,602. To arrive at CSXT's Georgia taxable fair market value the Department then deducted amounts for motor vehicles (which are separately valued and assessed for ad valorem tax purposes), exempt pollution control equipment and an exempt railroad line. The amount so determined equaled $514,862,671 and was presented to the State Board of Equalization for its approval in November 2002.

12. Following the Board's approval, the Department issued a notice of proposed assessment dated November 25, 2002 to CSXT, which reflected the following a) the Department's distribution of what had been determined as the total taxable fair market value of CSXT's operating property in Georgia among the various counties and municipalities in which the railroad had taxable property, and b) a proposed assessment for each such local jurisdiction, which was derived by multiplying the county's or municipality's distributed value by an assessment ratio that was either the statutorily mandated 40% or the prevailing level of assessment in that county as shown by a sales ratio study performed by the State Auditor.

Tegarden & Associates, Inc.
105 Point East Drive,
Nashville, TN 37216-1403
Telephone 615-226-2300

APPRAISAL
OF THE
OPERATING PROPERTIES
OF
CSX TRANSPORTATION INC.

AS OF
JANUARY 1, 2002

[PLAINTIFF'S EXHIBIT 1]

29

APPRAISAL
OF THE
OPERATING PROPERTIES
OF
CSX TRANSPORTATION INC.

AS OF

JANUARY 1, 2002

- BY -

TEGARDEN & ASSOCIATES, INC.

105 POINT EAST DRIVE

NASHVILLE, TENNESSEE 37216-1403

(615) 226-2300

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Nashville, TN 37216-1403
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November 14, 2003

Mr. James McBride
Baker, Donelson, BeaRman & Caldwell, PC
Lincoln Square
555 Eleventh Street, N.W. - 6th Floor
Washington, DC 20004

Re: Valuation of the operating properties of CSX Transportation Inc. as of January 1, 2002

Dear Mr. McBride:

In accordance with your request we have completed an appraisal of the operating properties of CSX Transportation Inc. as of January 1, 2002. Included in the operating properties are all real, personal, tangible and intangible property owned or used by CSX Transportation Inc. in its railroad business. The purpose of this appraisal is to estimate the market value of the operating properties of CSX Transportation Inc. which operates the largest railroad system in the eastern United States.

We have inspected and analyzed the financial records, gathered the necessary data, and made certain analyses that have enabled us to form an opinion of market value. The market value of the subject property in fee simple interest as defined in the appraisal report, as of January 1, 2002, was

SIX BILLION DOLLARS

($6,000,000,000)

The narrative appraisal report that follows describes the processes used in reaching conclusions, sets forth the assumptions and limiting conditions, and contains relevant data amassed

during our examination. This letter must remain attached to the report in order for the value opinion set forth to be considered valid. This report was prepared for and our professional fee billed to you. It is intended only for use by you, your internal management, and appropriate taxing authorities. It may not be distributed to or relied upon by other persons or entities without our written permission. If you have questions concerning the report, please contact us at (615) 226-2300.

Sincerely,

/s/ Thomas K. Tegarden
THOMAS K. TEGARDEN, MAI, CAE

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Summary of Salient Facts and Conclusions

1. Subject Property:	The operating properties of CSX Transportation Inc. (real, personal, tangible, and intangible owned and used)
2. Interest Appraised:	Fee simple interest
3. Type of Property:	A railway system operating over approximately 40,520 miles of track as of December 31, 2001
4. Area of Operation:	23 States in the United States and 2 Canadian Provinces
5. Purpose of Appraisal:	To estimate the market value of the operating properties of CSX Transportation Inc.
6. Date of Appraisal:	January 1, 2002
7. System Market Value Opinion:	$6,000,000,000
Cost Approach	$6,150,000,000
Income Approach	$5,983,000,000
Stock and Debt Approach*	$9,637,000,000

* Unadjusted for minority discount and liquidity premium.

Purpose of the Appraisal

The purpose of this appraisal is to estimate the market value of the operating properties of CSX Transportation Inc. (CSXT). The value opinion in this appraisal report is the market value as of January 1, 2002. The intended use of this appraisal is for assistance to the legal and property tax representatives of the Company in exercising their duties. This is a business valuation appraisal report prepared in accordance with Standards Rule 10-2, *Uniform Standards of Professional Appraisal Practice*, 2003 Edition, Appraisal Standards Board of the Appraisal Foundation. The value opinion in this appraisal report is the market value as of January 1, 2002, and is prepared for James McBride, Baker, Donelson, Bearman & Caldwell, PC, Lincoln Square, 555 Eleventh Street, N.W. - 6th Floor, Washington, DC 20004.

Description of Subject Property

The subject property of this report is the fee simple interest in all the operating properties, tangible and intangible, used in the operation of CSX Transportation Inc. Fee simple interest is defined as "*absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.*"[1] The operating properties consist of a broad spectrum of properties of a diverse nature, which include real, personal, tangible, and intangible property operated collectively by CSX Transportation Inc. to provide railway services to its customers. (*Where intangibles are not subject to ad valorem taxation, their value should be deducted from the unit value found in this appraisal. The contribution of all leased property used by CSXT in its railway operations is included in the value found in this report.*)

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[1] *The Appraisal of Real Estate*, 11th ed., (Chicago: Appraisal Institute, 1996), 137.

Definition of Market Value

The definition of market value is:

> The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.[2]

The *Standards of Professional Practice* of the Appraisal Institute require that the following items directly related to a market value definition must be included in every appraisal report.

1. Identification of the specified property rights to be appraised.
2. Statement of the effective date of the value opinion.
3. Specification of whether cash, or terms equivalent to cash, or other precisely described financing terms are being assumed as the basis of the appraisal.
4. If the appraisal is conditioned upon financing or other terms, specification of whether the financing or terms are at, below, or above market interest rates and/or contain unusual conditions or incentives. The terms of above-or below-market interest rates and/or other special incentives must be clearly set forth; their contribution to, or negative influence on, value must be described and estimated; and the market data support-

---

[2] Appraisal Institute, *The Appraisal of Real Estate*, 11th ed., (Chicago: Appraisal Institute, 1992), 22.

ing the valuation estimate must be described and explained.[3]

The value opinion found in this appraisal, to comply with the above-stated definition of market value, must be in terms equivalent to cash in U.S. dollars.

Function and Scope of Appraisal

The function of the appraisal is to determine the market value of the operating properties of CSX Transportation Inc., for ad valorem tax purposes according to law. The scope of this appraisal includes a comprehensive examination of all relevant financial data necessary for the determination of the market value of the operating assets of CSX Transportation Inc.

Economic Environment

2000-2001 Economic Recap

In early December 2000, most economists projected a soft landing for the economy during 2001. During the preceding five years, healthy financial markets and rapid increases in technology spending propelled the U.S. economy forward. The Country's growth cycle proved surprisingly sound, even in the face of external shocks such as the 1997 Asian financial crisis and the Russian credit-market panic of 1998. In the aftermath of both crises, output continued to expand, despite fears of a slowdown.[4]

However, as the first quarter of 2001 evolved, America's record-breaking expansion grew vulnerable. Technology demand weakened faster than expected, projections of 2001 sales and profits were revised downward at company after company, including such giants as Microsoft Corp. and SBC Communications Inc. Announcements of big workforce cuts

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[3] *Ibid.*

[4] "Industry Outlook", *Business Week*, January 8, 2001, 88.

became a common occurrence. American companies announced nearly two million job cuts during 2001, more than three times as many layoffs as in 2000.[5]

The slowdown also affected business and consumer spending decisions. Businesses became increasingly reluctant to undertake new investments that would expand productive capacity, and they sharply curtailed travel and other expenditures as sales opportunities diminished and profits declined.

According to the National Bureau of Economic Research, the agency that dates the American business cycle, the U.S. economic expansion that began in March 1991, was the longest peacetime expansion in American history. In September of 2000, the American economy was in its 114th month of expansion. This average was dominated by two long expansions: one ran for 106 months and dominated the decade of the 1960s, and the other ran for 92 months and dominated the decade of the 1980s.

However, the National Bureau of Economic Research placed the start of the economic downturn as March of 2001, thus ending the longest peacetime expansion in U.S. History. The beginning of recessionary times along with the dot.com and tech industry decline, the high oil and gas prices, major corporate layoffs, and the September 11, 2001 assault on the New York twin towers and the Pentagon in Washington, D.C. compounded the economic decline of 2001.

Economic Outlook for 2002

With the United States in a recessionary mode many consumers and economists are pointing their fingers of frustration. Some say Alan Greenspan raised rates too much, others say the rate cuts came too late. Some blame Joel Klein for suing Microsoft and causing the technology sector to chill

---

[5] "Nutting, Rex, "Nearly 2 Million Laid Off in 2001," CBS.Market Watch.com, January 3, 2002.

out. Others blame OPEC for raising oil prices. And, not surprisingly, some say it's all Wall Street's fault.

The current recession is unlike any other in the past 30 years. In the past, recessions have been rooted in weak consumer spending, typically induced by high interest rates. Then as consumer demand faltered, businesses would find themselves with unwanted inventories. They would cut back on orders, production and hiring until demand returned. Lay-offs would naturally occur. Eventually, the Federal Reserve would lower interest rates enough to spur demand, restoring growth, once inventories were low again.

However, that's not what happened to the U.S. this time. In fact, sales of homes and autos have remained strong, close to record levels. Consumers, despite the bear market, kept up their spending in 2001. Real consumer spending grew about 5 percent in 1998, 1999, and 2000. It has slowed to about one-half that now, according to Rex Nutting of CBS.Market Watch.com, December 17, 2001. In previous recessions, consumer spending turned negative.

So far, the Federal Reserve's rate cuts have had limited impact. Stock prices are down, longer-term interest rates are only down 10 basis points or so, and the dollar remains strong against other currencies. Despite a massive infusion of money into the economy, financial conditions are largely unchanged from year end 2000.

Economies evolve. Change is gradual and often hard to assess while it is happening. The New Year looks to be a lot better than 2001 because many economic factors are in place today that were missing last year. 2001 was the worst year for the U.S. economy since 1991.

Several important facts are the basis for a positive economic outlook. For one thing, the Federal Reserve cut interest rates 11 times during 2001, bringing the key federal funds rate down below the rate of inflation for the first time since

1994. Additionally, the Federal Reserve has lifted up the money supply also. The money measure known as M2 is, adjusted for inflation, growing at the fastest pace seen in about 30 years, according to Dr. Irwin Kellner, on CBS. MarketWatch.com, December 28, 2001.

On the fiscal side, there's been help as well. A $40 billion tax cut was implemented over the past summer, while spending on defense, national security and other items has gone up, both before and after the September 11, 2001, terrorist attacks. Additionally, energy prices have retreated. Since May of 2001, gasoline prices have fallen by over 50 cents a gallon. So while the economy still appears to be listing, the indicators that tend to look ahead suggest that the U.S. economic recovery is near.[6]

The economy, mired in a recession since March, will struggle to recover before summer of 2002 according to the article, "Economists look for sluggish recovery in 2002," by Rex Nutting in CBS.MarketWatch.com, December 17, 2001. "The recovery will come, but I don't think it'll be a strong recovery," said Irwin Kellner, chief economist at CBS. MarketWatch.com. Kellner is one of the more optimistic economists, figuring the economy will grow 1.5% during 2002. John Ryding, senior economist at Bear Steams reported that the economy during 2002 would be sluggish.

Predictions of growth for 2002 from the economic forecasters follows:

Irwin Kellner, chief economist at CBS.Market Watch.com	1.5%
Blue Chip Economic Forecasts (53 analysts)	1.0%
(In the 3rd & 4th quarter predictions increase to 3.5%)	

[6] Kellner, Dr. Irvin, "It's always darkest before the dawn," cbs.market watch.com, December 28, 2001.

BusinessWeek Forecasters (59 analysts)..... 1.5%
(In the last half of year. . . .3.5%)

Economy.com Inc..... 2.0%

Economists are in agreement that the recession that began in March of 2001 will likely be one of the mildest in the postwar era. By the second half of 2002, forecasters expect real GDP growth to pickup. And by year-end 2002, most economists predict the Federal Reserve to begin lifting interest rates, but only enough to shift monetary policy from its current accommodative mode to a more neutral stance.

The 59 economic forecasters from BusinessWeek warn us not to expect to return to the days of 4% to 5% real growth, soaring profits, and 30% gains in stock prices. They say those days are gone. Instead, look for economic activity that's governed by fundamental relationships. Consumer spending will grow more closely with household income. Capital spending will be guided by profits and cash flow, and stock prices will rise in line with more sensible expectations for risk and reward according to James C. Cooper and Kathleen Madigan in the December 31, 2001 article in BusinessWeek.com.

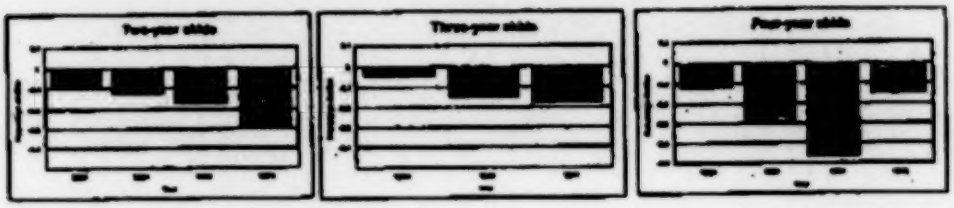
Stock Market

Two years into the 21st century's first bear market and the stock market is partying like it's 1999, according to an article by Mara Der Hovanesian, in BusinessWeek/online, December 31, 2001. The fourth quarter of 2001 rally brought about the highest returns since 1999 led by a 37% surge in the NASDAQ Composite Index since the September 21, 2001 lows. That percentage increase chopped the techladen index' year long losses to two-third those of 2000. The Dow Jones industrial average gained 19% in less than three months, and the Standard & Poor's 500 index climbed 8%. The recent gains in the broader market are impressive, but the Dow is still on tract to lose 8%, and the S&P to lose 13% overall for 2001, according to Hovanesian.

The Dow Jones industrial average will see its first back-to-back losses since the 1977-78 period, when the blue chip barometer declined 17.3% and 3.2%, respectively. And the S&P and NASDAQ will register their first two-year declines since the 1973-74 period.

Investors' pain was widespread in 2001. Using the Wilshire 5000 index as a gauge for the broad market, a total of $1.68 trillion in wealth was wiped out since the start of the year. The broad index is down 12% on the year.

S&P 500 losing streaks chart published in USA Today, January 2, 2002, reported by Bob Laird follows:



Source: Ned Davis Research

One argument that economists make for a sustained stock market rebound is historical precedent. Since World War II there have been ten bear markets which posted average declines of 29% and lasted just 15 months. The current bear market unleashed by the collapse of speculation in Internet stocks, a rout in business capital spending, and a plunge in profits has lasted longer at 19 months. It has also cut deeper, with declines in individual stocks of nearly 40% on average.

The economy and our Nation have been gripped by unusual uncertainties, many due to the terrorist attacks of September 11, 2001. We are in a new world of risk with radically altered markets - and investors will forget the lessons of 2000 and 2001 only at their peril according to an article, "Time to Get Back in the Game - Cautiously," written by Mike McNamee in the December 31, 2001 BusinessWeek/Online.

Thumbing through any current finance magazine will give the reader of this report an idea of how lousy the stock market treated investors during 2001. Investment firms are now pushing bond funds that yield slightly more than 5% according to an article by Adam Shell in January 2, 2002, USA Today, entitled "Single-digit returns might be sign of times." The skimpy 5% bond yield is slightly lower than the high single-digit gains stock investors can expect on average over the next decade, Wall Street experts say. Shell, in his article, reports that some say this is a reality check, a return to sanity, an end of an era. There is a growing consensus on Wall Street that tomorrow's stock returns will be far less exuberant than yesterday's gains.

Many experts believe the stock market is in the process of returning to more normal, or average returns after a decade of unusually large gains. It's called "reversion to the mean." Simply put, what goes up is likely to come down, and what goes down is likely to bounce back, according to Shell's article.

Jeremy Siegel, finance professor at the University of Pennsylvania's Wharton School of Business predicts that ours will be a world of lower returns and that people have outsize expectations. Fred Taylor, chief investment officer at U.S. Trust says, "The equity cult is dead." Why? He reports that a realization that the stock mania of the late 1990s was an aberration, not the dawn of a new era as many Wall Street analysts claimed. The clincher was the second down year in a row for the stock market. Investors now have a renewed sense of risk.

For the first time in many years, consumers, investors, stock analysts, economists and the Federal Government are all in agreement on our economy. At some point during 2002, and no one can agree when, our U.S. economy should make a come-back and eliminate the word "recession" from our vocabulary. All feel with the current recession not mirroring

recessions of the past, that coming out of a mild recession will spur mild growth. There is a wide divergence on what exactly that growth will be. Due to so many unusual uncertainties embedded in our current economy the risk level for corporate America is higher than it has been in the last ten years. Additionally fundamental business risk of industry has gone up.

Bonds

Bonds have beaten stocks for two years running. That may change in 2002. Thanks to the Federal Reserve's eleven rate cuts during 2001, short-term U.S. Treasury yields dipped to their lowest levels in decades. However, during the last six weeks of 2001 bond rates began creeping back up amid expectations that the economy would recover during 2002.

"Over the last two years bond investors earned most of their return from price gains, but 2002 will be about yield plays," says Kevin Cronin, chief investment officer for fixed income at Putnam Investments. William H,. Gross, portfolio manager of PIMCO Total Return, the Nation's largest bond fund with $48.8 billion in assets agrees. "Fears of a bear market in bonds over the next 12 months are exaggerated," Gross said in recent comments.

On October 31, 2001 the U.S. Treasury announced that it would stop issuing 30-year bonds, sparking the biggest bond market rally since the 1987 market crash. While the government had discussed eliminating the 30-year bond in the past, the October 31 announcement both surprised and angered bond investors, according to an article by Sandra Block, "Treasury to stop issuing 30-year bonds," at USAToday.com, October 31, 2001. By the end of the day on October 31, 2001, yields on U.S. Treasury bonds, which move in the opposite direction of prices, fell to 4.89%, down from nearly 5.2% the day before.

Many bond analysts believe the U.S. Treasury's main goal in wiping out the 30-year bond was to give the economy a boost by reducing the cost of long-term borrowing. While the Federal Reserve has reduced short-term rates 11 times this year, long-term rates haven't followed. The Federal Reserve generally has called the shots on rates and the Treasury, with this one action, has caused long-term U.S. Treasury yields to drop over 30 basis points in one day, says Bog Auwaerter, senior fixed income portfolio manager for Vanguard Group.

How are corporations handling their heavy debt loads? Since the recession was officially noted in March of 2001, nonfinancial corporations have issued new bonds by the truckload, driving up their total debt by $137 billion. By contrast, during the 1990-1991 recession, nonfinancial corporate debt rose only $5 billion according to an article, "The Threat of a Huge Debt Load," by Michael J. Mandel in "Economic Trends," at BusinessWeek/online, December 31, 2001.

Optimists argue that this time, companies were able to take on new debt and refinance old debt at low interest rates, making it less worrisome. And, interest paid is less than 4% of nonfinancial corporate output, compared with 6% during the last recession.

Nevertheless, new data from the Federal Reserve raises questions about corporate balance sheets. Nonfinancial corporate debt at a share of new worth now stands at 59%, a record level. Moreover, that's up from 54% a year earlier, the biggest four-quarter jump ever. By comparison, the ratio of debt to net worth at the end of the 1990-1991 recession was only 51% according to Mandel.

The high level of debt compared to net worth reduces the financial cushion of companies and makes them more vulnerable to unexpected shocks. For example, if inflation falls more sharply than expected and companies can't raise

their prices, the debt will be harder to repay. Finding flaws in a corporate financial system ahead of time is never easy. But it would be more reassuring if corporate America was not borrowing quite so much. This fact alone raises the investor's financial risk.

Summary

Where did the projected 2001 U.S. economic soft landing go? 2001 began with aggressive Federal Reserve rate cuts and lots of talk about an economic soft landing. With staggering losses from 2000 under their belts, investors figured, with Greenspan's help the U.S. soft landing was imminent. By mid-2001 all talk about a soft landing vanished. The U.S. recession began in March. The September 11, 2001, terrorist attacks in New York and Washington, D.C. produced devastation of unimaginable proportions and threw the economy even deeper in recession according to Jule Rannazzisi at CBS.MarketWatch.com, December 31, 2001.

As 2001 has ended, the U.S. economic recovery appears to be more an economic forecast rather than fact. The last economic data of 2001 indicates that industrial activity is still falling, retailers are showing lackluster sales, and businesses are laying off workers due to poor profits and dim future prospects. Most economists in general predict that the recession will end in 2002. The time period ranging from the first quarter to the last quarter, with more agreement that the recovery will occur during the last half of 2002. The combination of deep interest-rate cuts by the Federal Reserve and last year's tax-rate reductions should have the intended effect of warding off a precipitous downturn.

In an article by James C. Cooper and Kathleen Madigan in BusinessWeek, January 14, 2002, both authors suggest that growth this year will be driven by time-tested fundamentals, not unsustainable fads. Instead 2002, will see the return of the back-to-basics economy. Forget the wealth effect from stock-

price bubbles. Consumer spending in 2002 will grow more in line with gains in take-home pay. Companies will take a more prudent approach to new technology as more realistic expectations about sales and profits will dictate capital budgets.

As recoveries go, however, this one won't be very impressive. The growth rate, measured from the fourth quarter of 2001 to the fourth quarter of 2002, will be in the range of 1% to 3.5% (see chart above), according to the economic analysts reported in this report. Again, most of the analysts feel the economic recovery will likely be in the last half of 2002.

Corporate financial and business risk has not been as high in the last ten years as it is entering the year 2002. Confronting and controlling those risks was the theme of Business Week's Investment Outlook for 2002.

2002 Economic Outlook - Railroad Industry

From a monetary policy perspective, the Federal Reserve responded early in 2001 to signs of economic weakness by lowering short-term interest rates aggressively (eleven times). Longer-term rates, such as those tied to 30-year mortgages fell as well. Businesses were able to take advantage of the lower interest rates to restructure their balance sheets, paying off high debt using lower-interest loans. The federal government also loosened its fiscal policy stance as evidenced by the summer income tax rebate program aimed at stimulating household spending.

Whether the policy measures enacted in the first eight months of 2001 would have been sufficient to prevent the degree of contraction seen in the overall economic activity is not clear according to the Fourth Quarter 2001, EconSouth produced by the Federal Reserve Bank of Atlanta. What is clear, however, is that the tragic events of September 11, 2001, exacted a substantial toll on the Nation's economy, leading to a decline in overall economic activity.

The United States economy entered 2002 on a slowing trend which affected businesses. They became increasingly reluctant to undertake new investments that would expand productive capacity, and they sharply curtailed travel and other expenditures as sales opportunities diminished and profits declined. Much of the freight carried by railroads is extremely sensitive to the economy and, therefore, has experienced a sharp decline in recent months as the United States' economy slowed. W. R. Pekowitz, Jr., in his December 14, 2001, "Railroad Industry" report for *Value Line* said cost-cutting measures and smoother operating networks should allow for continued improvement in railroad operating ratios. Freight demand is highly correlated to business and economic activity. Because of this, the recession has hampered carload volumes at all of the railroads reported Pekowitz.

The year 2001 was quite different for the transportation environment. Coal volumes, which drove much of the railroad revenue gains through the first seven months of 2001, showed signs of contracting the last several months of 2001. Pekowitz reported that *VL* believed the combination of lower natural gas prices, a relatively mild summer coupled with a warm fall, and problems at the coal mines was the blame for much of the decline. The weather situation, according to Pekowitz, has allowed the utilities that rely on coal energy to replenish stockpiles, thereby reducing demand for additional orders. Thus, if the weather does not return to more normal patterns in January and February 2002, coal volumes could be severely hampered through the winter

In the EIA's "Short-Term Energy Outlook - February 2002, released February 6, 2002, very mild winter weather conditions were projected to continue to dampen heating season energy demand patterns. Heating degree-days in January 2002 were about 14-17 percent below normal (depending on the region) and below year-ago levels. For the entire winter heating season (Quarter 4 2001 - Quarter 1 2002), a return to

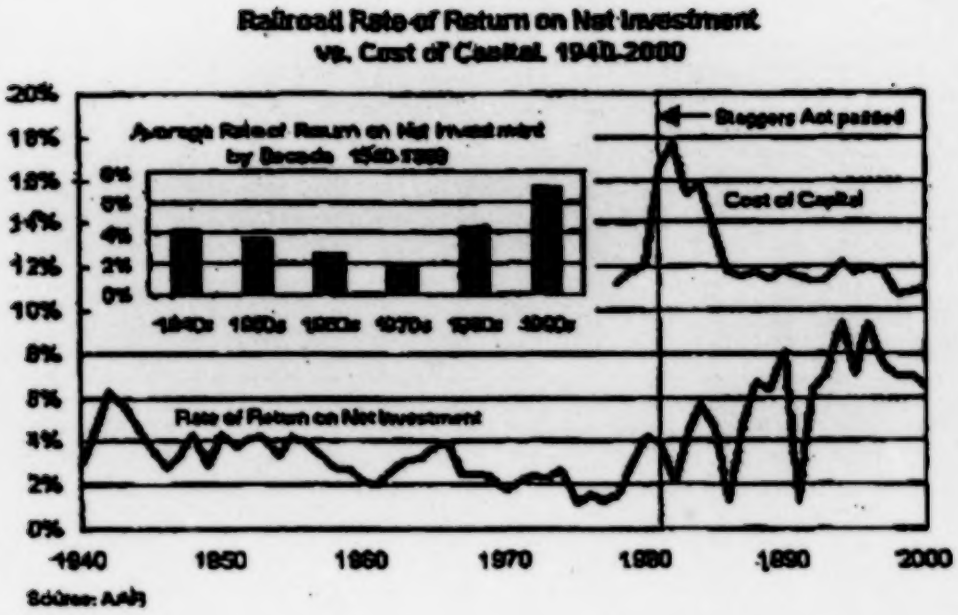
normal for the time remaining will still imply a year-over-year decline of about 17 percent in heating degree days, thus affecting the coal volumes that the rail industry transports. United States based rail carriers, especially Norfolk Southern, CSX, and Burlington Northern Santa Fe, which have relied on coal to support much of their growth of late, will be hard hit and could experience top-line contraction is the EIA's short-term energy outlook is correct, according to *VL's* Pekowitz.

Railroad Industry Performance and Outlook

Railroad Industry — History and Overview

In the 1970s, the cumulative effects of decades of rigid and arcane government regulation brought the U.S. rail industry to the brink of ruin. More than 20 percent of the nation's rail mileage was accounted for by railroads in bankruptcy; return on investment averaged just two percent; and railroads could not afford the massive investments necessary to modernize and maintain their infrastructure. Because the status quo was not tenable, the government had two choices: nationalization, at a continuing cost of billions of dollars, or reliance on the free market. The government wisely chose the free market and passed the Staggers Rail Act of 1980.

In enacting the Staggers Rail Act, Congress recognized that railroads faced intense competition from trucks and other modes for most freight traffic, but prevailing regulation prevented them from earning adequate revenues and competing effectively. Railroad survival required a new regulatory scheme that allowed railroads to establish their own routes, tailor their rates to market conditions, and differentiate rates on the basis of demand. Since then, the rebirth of the railroads has exceeded all expectations.



Mergers and Acquisitions in the Railroad Industry (1995 - 1999)

Railroad profitability has improved since the Staggers Rail Act, but railroads are still not earning competitive returns. Since 1978, the Interstate Commerce Commission (ICC)/ Surface Transportation Board (STB) has annually determined the revenue adequacy of individual Class I railroads. A railroad generates adequate revenue — *i.e.*, it is earning enough to cover all costs of efficient operation, including a competitive return on capital — when its rate of return on net investment (ROI) equals or exceeds the rail industry's current cost of capital (COC). The STB standard is similar to that used by public utility regulators throughout the country. The average rate of return on net investment — which had been falling for decades — rose from an annual average of 2.0 percent in the 1970s to 4.4 percent in the 1980s and 7.0 percent from 1990-2000. The rail industry still falls well short of earning its cost of capital, but the gap has narrowed according to the Association of American Railroads. The graph above, from the *www.aar.org* site, illustrates the point well.

The U.S. freight railroad industry has undergone substantial changes over its 170-year history. Today's freight railroad industry is vital and competitive, due in large part to the reforms enacted in the Staggers Rail Act of 1980.

At the time the Staggers Rail Act was enacted there were about 40 rail carriers that carried freight in the railroad industry. The restructuring of the major railroads ensued as a result of the Staggers Rail Act and partial deregulation. Class I Railroads are U.S. line haul freight railroads with operating revenue in excess of $261.9 million.

Six of the mergers and acquisitions that have occurred from 1995 to 1999 are: (1) Canadian National acquired Illinois Central in 1999; (2) Norfolk Southern acquired a 58% interest in Conrail in 1998; (3) CSX acquired 42% of Contrail in 1998; (4) Union Pacific acquired Southern Pacific in 1996); (5) Union Pacific acquired Chicago/North Western in 1995; and (6) Burlington Northern acquired Santa Fe Pacific in 1995.

Two Canadian railroads, Canadian National Railway and Canadian Pacific Railway, have enough revenue that they would be Class I railroads if they were U.S. companies. Both companies also own railroads in the United States that, by themselves, qualify to be Class I railroads. Two Mexican railroads, Ferrocarril Mexicano and TFM, would also be Class I railroads if they were U.S. companies. The Class I railroads in 2000 were: The Burlington Northern Santa Fe Railway, CSX Transportation, Grand Trunk Western Railroad, Illinois Central Railroad, Kansas City Southern Railway, Norfolk Southern Combined Railroad Subsidiaries, Soo Line Rail-road, and Union Pacific Railroad, according to a February 4, 2002 report on "Class I Railroad Statistics" published by the Association of American Railroads - Policy & Economics Department and provided at their *www.aar.org* website.

Median Return on Equity
Class 1 Railroads vs. Fortune 500 Companies

	Median ROE		No. of	Class 1
Year	Class 1 RRs	Fortune 500 Cos.	Fortune 500 Ind.	RR Rank
1985	5.3%	11.6 %	26	25th
1986	0.0	11.6	25	25th
1987	7.0	13.2	25	24th
1988	8.6	16.2	25	23th
1989	4.3	15.0	25	25th
1990	8.3	13.0	25	23rd
1991	1.0	10.2	25	23rd
1992	7.6	9.0	25	14th
1993	8.0	11.9	35	26th
1994	11.3	13.7	35	27th
1995	5.9	14.0	36	35th
1996	11.6	14.1	38	30th
1997	10.4	13.9	37	30th
1998	11.5	13.4	38	28th
1999	8.8	15.2	41	34th
2000	9.4	14.6	48	40th

Source: AAR, *Analysis of Class I Railroads, Fortune*

Railroad Profitability

For years prior to railroad deregulation in 1980, the term "railroad profits" was an oxymoron. Since enactment of the Staggers Rail Act, rail profitability has improved. Even with their improvements, though, railroad earnings are still not sufficient to cover all costs of rail operations, and railroads generally lag other U.S. businesses with which they compete for capital.

Return on equity (ROE) is a commonly used indicator of short-term profitability. According to Fortune 500 data, in the 16 years from 1985 to 2000, overall railroad ROE was less than the Fortune 500 average each year, and usually lower than the ROE of individual industries which rely heavily upon rail transportation.

In all but 3 of the 16 years, the railroad ROE was in the lowest quartile among Fortune 500 industries. In 8 of the 15 years, at least 92 percent of other industries had higher ROE than the railroads. Similar analyses using data from the S&P 500, *Business Week*, and *Value Line* all yield similar results: Class I railroads typically register returns substantially inferior to those of other industries. The graph on the preceding page depicts the median return on equity of Class I Railroads vs. Fortune 500 Companies and was taken from the *www.aar.org* website.

Likewise, in most of the past 15 years, the dividend yield for the railroad industry has been lower than the S&P 500 average.

The cost of funds from the capital markets depends, in part, on the financial rating of the railroad companies. In general, railroads' ratings are middling to lackluster and at the bottom of so-called "investment grade" bonds. The bond ratings of virtually every major railroad have been downgraded at least once in recent years. Moreover, relatively low profitability is

a major reason why railroad stocks have significantly underperformed the market in recent years.

Price Earnings Ratios and Dividend Yields of Class I Railroads vs. S&P 500 Industries

	P/E Ratio		Dividend Yields	
	RRs	S&P 500	RRs	S&P 500
1985	9.1	12.9	3.5%	4.3%
1986	13.4	15.8	3.4%	3.7%
1987	12.1	16.0	3.0%	3.3%
1988	11.0	11.1	4.5%	3.7%
1989	11.7	13.9	3.5%	3.5%
1990	12.0	15.3	3.6%	3.8%
1991	21.5	22.4	3.5%	3.4%
1992	16.2	21.9	2.3%	3.0%
1993	16.6	20.6	2.3%	2.8%
1994	14.1	15.1	2.4%	2.9%
1995	14.8	15.9	2.2%	2.6%
1996	14.7	17.2	2.0%	2.3%
1997	16.8	27.5	1.9%	1.5%
1998	21.0	32.8	1.9%	1.3%
1999	16.5	32.1	2.0%	1.2%
2000	15.4	27.1	2.9%	1.0%

Source: AAR, various industry reports

In general, railroads fall below those companies which are judged to possess "high quality" or "favorable investment attributes" and above those companies which "face major ongoing uncertainties" and which "lack characteristics of

desirable investment." According to Fortune 500 data, Class I railroads had lower return on assets than the Fortune 500 median in 12 of the 16 years from 1985 to 2000. Compared to industries that are significant rail shippers, railroads had lower return on assets more than two-thirds of the time. Price/earnings ratios and dividend yields are, at best, short-term measures of financial health. Yet even for these, for each of the 16 years from 1985 to 2000, the price/earnings ratio for railroads has been lower than the average ratio for the S&P 500 companies. Likewise, in most of the past 15 years, the dividend yield for the railroad industry has been lower than the S&P 500 average, as the American Association of Railroads graph above indicates. All of the political and economic factors discussed in this section will affect the typical investor's cost of capital as the elements of business and financial risk increase.

Factors Affecting The Railroad Industry

The recent collapse of the Houston-based energy giant Enron Corp. has virtually all the ingredients for scandal in Washington and then some, according to an article January 24, 2002 titled "Enron and Anderson," in opensecrets.org. Enron's imminent collapse quickly landed it in the penalty box. In an age when giant earnings write-offs have become commonplace, it's hard to shock Wall Street. But on November 8, 2001, Enron Corp. managed to do it. After years of high-octane growth, the Houston-based energy company acknowledged that results for the past three years were actually overstated by more than half-billion dollars. This was confirmation of an investor's worst fears, according to an article in BusinessWeek, by Byrnes and Henry, November 26, 2001. Although up to 800 companies have some exposure to the Houston-based energy-trading firm, losses are unlikely to trigger a chain of failures. (Last year was a record one for bankruptcies: 255 stock-market companies filed for Chapter

11 compared with 176 in 2000, a 45 percent increase, according to CBS MarketWatch.com, January 17, 2002.)

According to the National Bureau o f Economic Research, the agency that dates the American business cycle, the U.S. economic expansion that began in March 1991, the longest peacetime expansion in American history, started its economic downturn by March of 2001, thus ending the longest peacetime expansion in U.S. History. The beginning of recessionary times along with the dot.com and tech industry decline, the high energy prices, major corporate layoffs, and the September 11, 2001 assault on the New York twin towers and the Pentagon in Washington, D.C., and the Enron bankruptcy filing compounded the economic decline of 2001. Economists project the turnaround to begin somewhere between the second and last quarter of 2002 with most forecasting the economic rebound to occur the last half of the year.

The overriding theme of the railroad industry appears to be that freight demand is highly correlated to business and economic activity. Because of the United States economic recession, coupled with the economic aftermath of September 11, 2001, carload volumes have been hampered at all of the railroads. The intermodal and metals businesses have been especially hard hit, as these two groups are more reliant on economic activity than other commodities according to W. R. Pekowitz, Jr. in the December 14, 2001, "Railroad Industry," report by *Value Line*. He continued to say that a number of companies have cited the weakening economy as the reason for a less-optimistic earnings. All of the factors listed above point to continued elevated business and financial risk which is reflected in the weighted average flotation adjusted cost of capital.

Brief History and Company Statistics

CSX Transportation Inc. (CSXT or the Company) is an operating Class 1 railroad with operations in the United States and Canada and is engaged principally in the business of railroad transportation. CSXT is a wholly-owned subsidiary of CSX Corporation (CSX), a publicly-owned Virginia corporation with headquarters in Richmond, Virginia. Headquartered in Jacksonville, Florida, CSXT conducts railroad operations in its own name and through railroad subsidiaries.

CSX Transportation Inc. is the largest railroad in the eastern United States. Its rolling stock includes more than 3,600 locomotives and 100,000 railcars, which in 2001 hauled nearly 5.1 million carloads of freight. Headquartered in Jacksonville, Florida, CSXT accounted for 75% of CSX's operating revenue and 78% of operating income in 2001.

Rail shipments include merchandise traffic, automobiles and related products, and coal, coke and iron ore. Merchandise traffic accounted for 57% of rail revenue in 2001, while automotive traffic accounted for 13% and coal, coke and iron ore accounted for 29%. Merchandise traffic includes chemicals, paper and forest products, agricultural products, minerals, metals, phosphates and fertilizer, and food and consumer products. Coal shipments originate principally from mining locations in the eastern United States and primarily supply domestic utility and export markets.

The Company operates various facilities and equipment to support its transportation system, including its infrastructure and locomotives and freight cars. The Company also owns or leases other equipment to support rail operations, including highway trailers, containers and vehicles. Support facilities for rail operations include yards and terminals throughout its rail network, system locomotive shops to perform locomotive servicing and maintenance, a centralized network operations

center for train dispatching and network operations monitoring and management.

Regulation

Rail operations are subject to the regulatory jurisdiction of the Surface Transportation Board (STB) of the United States Department of Transportation (DOT), the Federal Railroad Administration of DOT, the Occupational Safety and Health Administration (OSHA), and state regulatory agencies. The STB, which is the successor to the Interstate Commerce Commission (ICC), has jurisdiction over disputes and complaints involving certain rates, routes, and services, the sale or abandonment of rail lines, applications for line extensions and construction, and consolidation or merger with, or acquisition of control of, rail common carriers. The outcome of STB proceedings can affect the costs and profitability of CSXT's railway business.

Regulations are enforced by the STB and require periodic formal studies of ultimate service lives for all railroad assets. Resulting service life estimates are subject to review and approval by the STB. For retirements or disposals of depreciable rail assets that occur in the ordinary course of business, the asset cost (net salvage value or sales proceeds) is charged to accumulated depreciation and no gain or loss is recognized. For retirements or disposals of depreciable non-operating property, and for all dispositions of land, gains or losses are recognized at the time of disposal. Expenditures that significantly increase asset values or extend useful lives are capitalized. Repair and maintenance expenditures are charged to operating expense when the work is performed.

Mergers and Acquisitions

CSX and Norfolk Southern Corporation (Norfolk Southern) completed the joint acquisition of Conrail Inc. (Conrail) in May 1997. Conrail owns the primary freight railroad system serving the northeastern United States, and its rail

network extends into several midwestern states and into Canada. CSX and Norfolk Southern, through a jointly owned acquisition entity, hold economic interests in Conrail of 42% and 58%, respectively, and voting interests of 50% each. CSX and Norfolk Southern received regulatory approval from the STB to exercise joint control over Conrail in August 1998, and their respective rail subsidiaries subsequently began integrated operations over allocated portions of the Conrail lines in June 1999.

Under this operating plan, CSXT added approximately 4,400 route miles of track in the northeastern and midwestern United States and in Canada to its existing lines concentrated in the Middle Atlantic and southeastern United States. To service the new operations, approximately 5,600 former Conrail employees joined the Company. CSXT now operates a network of approximately 23,000 route miles in 23 states, the District of Columbia, and two Canadian provinces. CSXT employs approximately 35,000 employees across the combined system.

Competition

The business environment in which the Company operates remains highly competitive. Depending on the specific market, deregulated motor carriers, other railroads and river barges may exert pressure on price and service levels. The presence of advanced, high service truck lines with expedited delivery, subsidized infrastructure and minimal empty mileage continues to affect the market for non-bulk, time sensitive freight. The potential expansion of longer combination vehicles could further encroach upon markets traditionally served by railroads.

As railroads streamline, rationalize and otherwise enhance their franchises, competition among rail carriers intensified. Competition is from several Class 1 railroads and numerous

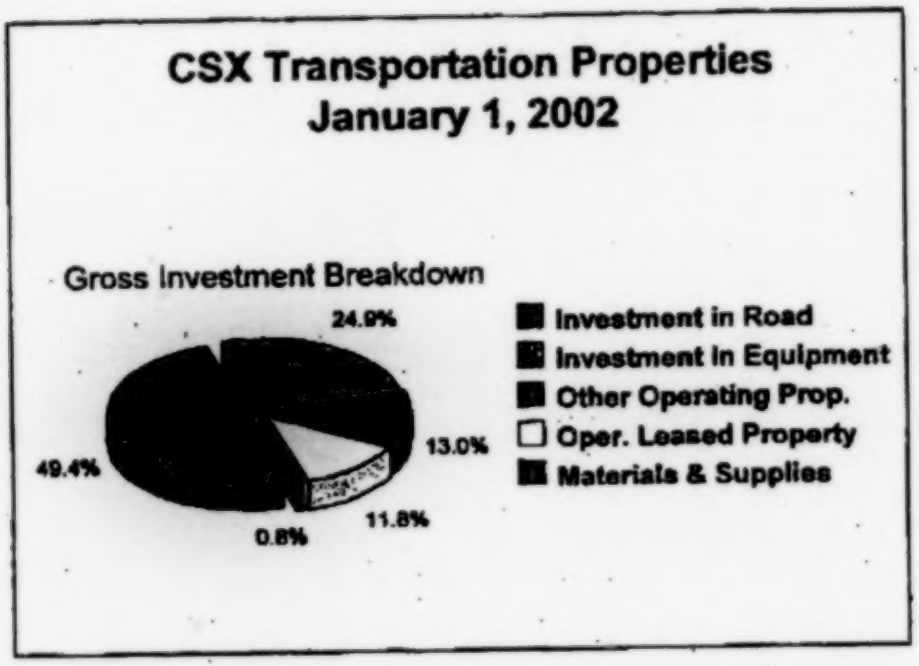
regional railroads and motor carriers that operate in parts of the same territories served by the Company.

Market Risk

The Company is subject to risk relating to changes in the price of diesel fuel. Forward purchase agreements have been entered into with various suppliers for approximately 294 million gallons of fuel, which is approximately 50% of the 2002 requirement, at a weighted average price of 78 cents per gallon. The Company is subject to fluctuations in prices for the remainder of its 2002 needs. A one cent change in the price per gallon of fuel would impact fuel expense by approximately $3 million.

Below is a graph showing a breakdown of CSXT's net investment figures as of December 31, 2001. An organization chart of CSX Corporation, its subsidiaries and affiliates as of December 28, 2001, can be found in the Addendum of this report.

Breakdown of Net investment (Graph)



Appraisal Procedures for Railroad Operating Property

The purpose of this appraisal is to estimate the market value of the operating property of CSX Transportation Inc. The operating physical real and personal property assets of the Company are integral parts of an ongoing business. In this appraisal, we are appraising the *going-concern value* of these integrated assets. The Appraisal Institute defines *going-concern value* as the market value of the tangible and intangible assets of an established and operating business with an indefinite life, as if sold in aggregate.[7] Further, the Appraisal Institute notes that the term *going-concern* has been replaced with *total assets of the business* (TAB), which includes real property, tangible personal property, and intangible personal property.[8]

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[7] Appraisal Institute, *The Appraisal of Real Estate*, 12th ed., (Chicago: Appraisal Institute, 2001), 27.

[8] *Ibid.*, 642.

When appraising all of the operating properties of a railroad company the unit appraisal concept may be applied.[9] Under the unit appraisal concept, the value of the properties being appraised is then determined by measuring their contribution to the overall unit value. The contribution is typically measured by some allocation process. This is a fundamental premise based on the appraisal principle of contribution. The Appraisal Institute defines and discussed the principle of contribution as follows:

> *The concept of contribution states that the value of a particular component is measured in terms of its contribution to the value of the whole property, or as the amount that its absence would detract from the value of the whole.* The cost of an item does not necessarily equal its value. A swimming pool that costs $10,000 to install does not necessarily cause the value of a residential property to increase by $10,000. Rather, the pool's dollar contribution to value is measured in terms of how valuable its benefit or utility is in the market. Its contribution to value might be lower or higher than its cost. Thus, in some cases, a property's market value may not increase even though the physical real estate has undergone alteration, modification, or rehabilitation.[10]

The steps that must be taken in the unit appraisal process are:

1. Determine the unit to be appraised.
2. Estimate the unit or system value.

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[9] The unit appraisal concept is the appraisal of an integrated property as a whole, without reference to the value of its component parts. The unit appraisal concept is the opposite of the *summation appraisal concept*, which is the summing of two or more of the appraisals made of fractional parts of the whole.

[10] Appraisal Institute, *The Appraisal of Real Estate*, 10th ed., (Chicago: Appraisal Institute, 1992), 41.

3. Allocate the appropriate portion of the unit or system to the taxing district.

First, the unit to be appraised is generally the operating property of the railroad company, whether such property is owned or leased. The non-operating properties a railroad company may have are generally appraised individually, independently of the operating unit, or are allocated out of the operating unit.

Second, following the determination of the unit to be appraised, the three indicators or approaches to value are used to determine the market value of the operating property of the railroad company. They are the cost approach, the income approach, and the sales comparison approach. While it may not be possible or practical to use all three approaches in the appraisal process, all should be considered.

Third, once the unit or system value is determined, a proper value is allocated to the taxing district. The allocation process is accomplished through the use of allocation factors which relate to the property being appraised.

There are problems peculiar to the appraisal of integrated business operating properties and these properties are typically best suited to the unit appraisal concept of valuation. Usually a company's property that extends over several taxing districts, such as the property of CSX Transportation Inc., has value and maintains value because it is operated as a system or unit. A railroad company is operated as a unit, provides services as a unit, and reports its financial operating results as a unit. Further, to whatever degree the properties are regulated, the state and federal regulatory authorities essentially exert their regulatory controls and decisions over the operating property as a unit. Thus, the very nature of a railroad company and its property makes it a suitable candidate for the unit appraisal process.

In circumstances where one is dealing with properties that are frequently bought and sold, one would normally have sales of comparable properties to help in the determination of market value. However, in the case of properties the size of the operating property of CSX Transportation Inc., there are not reliable, arms-length comparable sales to help determine the market value. Thus, the appraiser must gather the pertinent operating, financial, and economic information available, determine how it would affect a potential buyer and the seller of the operating properties, and make a judgment determination of the market value of the property.

The three approaches to value — the cost, income, and sales comparison approaches — and how these approaches are applied in the determination of a railroad company's operating property value will be discussed in this report. These three approaches are applicable to all other types of property that are locally appraised or assessed. The same appraisal principles which apply to any type of property, individually appraised/assessed or unit appraised/assessed, are equally applicable to the appraisal of the operating property of a railroad company. The most meaningful appraisal principles in the appraisal of railroad properties are:

1. The *Principle of Anticipation* holds that value is created by the anticipation of future benefits. When appraising income-producing property, such as a railroad, the future benefits are the anticipated future income of the property.

2. The *Principle of Consistent* Use holds that the property must be valued with a single use for the entire property. It is improper to value a property on the basis of one use for a portion of the property and another use for the remainder of the property.

3. The *Principle of Contribution* holds that the value of a component part of a property depends upon how

much it contributes to the value of the whole. This principle is applied in the unit appraisal process as well as in allocating a part of the whole system value to a state or taxing district or to the various component parts of the property.

4. The *Principle of Substitution* holds that a prudent purchaser will pay no more for a property than the cost of acquiring an equally desirable substitute property, having the same level of risk as the subject property, on the open market.

5. The *Concept of Highest and Best Use* is defined as that use among reasonable probable and legal alternative uses which is found to be physically possible, appropriately supported, financially feasible, and which will support the highest present value. When appraising railroad equipment which is a necessary part of the system, the only use permitted by certain governmental restrictions (STB and DOT) and international agreements is the present use; thus making it the highest and best use of the subject property.

Highest and Best Use

The subject of this report includes all the tangible and intangible operating properties owned and used by CSX Transportation Inc. These properties are of a diverse nature and are specifically adapted for use in the railroad industry. While some of the properties could be used in other applications (desks, chairs, certain land and buildings, etc.), the vast majority are specifically designed for railway service.

The properties must be valued at their highest and best use, which means the use that results in the greatest value and is "*. . . legally permissible, physically possible, financially feasible, and maximally productive.*"[11] These tests are often

[11] *The Appraisal of Real Estate*, 11th ed., (Chicago: Appraisal Institute, 1996), 303.

considered in sequence and the tests of legal permissibility and physical possibility must be applied before the remaining test of financial feasibility and maximal productivity. CSXT has been in business as a provider of railway service since 1944. Thus, the current use of the properties is legally permissible and physically possible. The financial feasibility of the use of these properties in railway service has been demonstrated historically leaving only the test of maximal productivity. The railroad industry is currently undergoing changes in many areas. The historical regulations that have limited the operations of railroad companies have been for the most part deregulated. Now however, competitive pressures restrict the use of the property in many ways. Because of the changes in the industry, the risk associated with the operation and ownership of these types of properties is greater now than at any time in the past. Based on the tests applied, it is our opinion that the highest and best use of the subject property in this report is to continue providing railway service.

Next, each of the three approaches and their applicability for appraising the operating property of CSX Transportation Inc. are analyzed and discussed.

The Cost Approach

The cost approach has been considered in the valuation of the operating properties of CSX Transportation Inc. It is important to recognize that sacrificing or expending factors of production does not necessarily establish value equal to the cost or sacrifice. To establish value, the expended factor of production must produce goods or services that have utility — are scarce and in demand in an economic sense. The degree of utility of a good or service is measured, of course, by either the price obtainable or the income that these goods or services can generate. As referenced earlier from *The Appraisal of Real Estate*, ". . . cost does not necessarily equal value." The Institute goes on to state that a property may have much cost and yet have little value.

> Cost is either a retrospective fact or a current estimate. It may or may not have a direct relationship to the utility (present or future) of the property created. Consider, for instance, the classic example of the luxury hotel built in an unpopular location. The hotel might cost much to build but have little value because of the lack of business.[12]

Additionally, the Appraisal Institute notes (as mentioned on page 18) that in discussing business enterprise value the term *going concern* has been replaced with *total assets of the business* (TAB). The Institute goes on to state,

> In assignments involving the market value of the total assets of the business, the cost approach offers little insight.[13]

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[12] American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, 8th ed., (Chicago: American Institute of Real Estate Appraisers, 1983), 35.

[13] Appraisal Institute, *The Appraisal of Real Estate*, 12th ed., (Chicago: Appraisal Institute, 2001), 643.

Thus, in the appraisal of the TAB of the CSX Transportation Inc. the cost approach can be expected to offer little insight in the estimation of market value.

When considering the cost of railroad property, several types of cost may be analyzed and considered. Some of the cost data that have been considered are:

1. *Original Cost* - The cost at the time a property was originally acquired or constructed and placed into public service.

3. *Reproduction Cost* - The cost of reproducing a new replica property on the basis of current prices, with the same or closely similar material.

4. *Replacement Cost* - The cost of replacing a property with an equally desirable substitute property.

Appraisers cannot categorically accept any of the above costs as market value. There are times when each of these costs would be the same as market value. When a property is new and a proper improvement, the original cost, reproduction cost, and replacement cost could all closely approximate market value. Market value is also affected when a company is unable to earn a return on certain items. In considering the different types of cost, the appraiser must keep in mind the type of property being appraised and consider all government regulations or restrictions placed on the property, or advantages enjoyed by the property.

Each of these costs is intended to be a measure of the value of the subject property when in a new condition. Where the passage of time and use has aged the property, the cost when new must be reduced. This reduction will reflect accrued depreciation from all causes. The three types of depreciation are defined as follows:

1. *Physical Deterioration* - This is the physical wearing out of the property. Deterioration is evidenced by

such physical effects as wear and tear, decay, dry rot, cracks, encrustations or structural defects. It is considered to be the loss in value due to the normal aging process. The level of maintenance of the property affects physical deterioration.

2. *Functional Obsolescence* - This is a loss in value due to certain functional deficiencies or inadequacies within the property itself. In railroad property, functional obsolescence would result from the development of new equipment and machinery that would cause the old equipment to be obsolete before it was physically worn out.

3. *External Obsolescence* - This is the loss in value from causes outside the property itself. Economic forces such as supply and demand and governmental regulations, which place limitations on the company's earning power, result in a loss of value to the property of a railroad company. This loss is external to the property of a railroad company and is measurable as external obsolescence to the railroad company.

The cost approach is used in some form by most appraisers of properties. It is recognized that in valuing a railroad company's property, cost — less an allowance for accrued depreciation — is an item which should be considered in arriving at the market value. Cost can be important even if the property is earning what appears to be an inadequate return.

In the appraisal of the operating property of CSX Transportation Inc., we have attempted to measure all forms of depreciation. We have used the original cost information less physical and functional depreciation, as reported in the Annual Report of CSX Transportation Inc. to the Surface Transportation Board (ACCA-R1) for year ended December 31, 2001. External obsolescence was measured in exactly the same manner stated and directed by recognized appraisal

authorities. *(Please see Explanation of Cost Approach on page 26.)*

In the appraisal of the operating property of CSX Transportation Inc., all types of cost have been given consideration. Original cost less the accrued depreciation (physical, functional, and external) can be used as an indicator of market value by the cost approach provided all forms of depreciation are measured and accounted for.

Either original cost or replacement cost can be used as the basis of the cost approach for the subject property as long as the measurement of depreciation is correctly tailored for each type of cost. If replacement costs were used, more external obsolescence would have to be deducted due to the magnified earnings deficiency based on this type of cost. The use of depreciated replacement cost (after the deduction of all the extra external obsolescence) would produce a figure consistent with the original cost less all depreciation (including a proper adjustment for obsolescence).

On the following page are the computations for the cost approach for the operating property of CSX Transportation Inc.

CSX TRANSPORTATION, INC.
Indication of Value by Cost Approach
January 1, 2002

Investment in Road Property (Sch 330)		$10,887,608,000
Investment in Equipment (Sch 330)		5,477,006,000
Unallocated Items		134,859,000
Other Investment in Railroad Property (Sch 352B)		2,735,196,000
Total Road & Equipment Property		$19,234,669,000
Less: Depreciation and Amortization		4,419,645,000
Depreciation and Amortization (Sch 352A)		707,615,000
Net Road & Equipment Property		$14,107,409,000
Add: Materials & Supplies		181,385,000
Total Net Property + Materials & Supplies		$14,288,794,000
Add Operating Leased Property (Net)		1,702,041,227
Total all Property (owned and leased)		15,990,835,227
Less: Obsolescence adjustment (see below)		
$15,990,835,227 x	61.54%	9,840,759,999
INDICATED VALUE BY COST APPROACH		$6,150,075,228
(Rounded)		$6,150,000,000

Obsolescence / Enhancement Estimate – January 1, 2002

RETURN ON TOTAL NET PLANT (1996-2001)

Year End	Net Operating Income*	Net Plant December 31	Return on Avg. Net Plant
1996	—	$10,628,201,647	—
1997	$877,000,000	10,952,004,077	8.13%
1998	781,000,000	11,531,933,757	6.95%
1999	684,000,000	15,682,448,382	4.90%
2000	642,000,000	15,805,236,141	3.46%
2001	622,000,000	15,990,835,227	3.91%
		5-Year Average	5.47%
		3-Year Average	4.09%
		2-Year Average	3.69%
		Selected =	4.50%

Return on Average Net Plant (from above)				4.50%
Rate of Return Required by Investors =				11.70%
Percent Actual Rate of Return of Investor Required Rate of Return =				38.46%
Percent Obsolescence in Existing Plant:				
100.00%	less	38.46%	=	61.54%

* NOI from Annual Supplement to CSX Corporation Annual Report (Rail), p. 3.

Explanation of Cost Approach

The basis of the cost approach used in this appraisal is original cost less depreciation. As stated in the introduction to the cost section of the report, replacement cost less deprecia-

tion and all obsolescence would approximate original cost less depreciation and obsolescence. Because of the facts set out above, we have used the original cost less depreciation as the basis of the cost approach. This cost includes road and equipment property and equipment, land, construction work in progress, materials and supplies, and leased property. The total net investment in operating railroad property of CSX Transportation Inc., on January 1, 2002, is $15,990,835,227.

A prospective purchaser of the operating property of CSX Transportation Inc. would require a market rate of return. If the adjusted net operating income is divided by the average net property investment which earned that income, the rate of return on assets can be calculated. The rate of return for the last five years has been between approximately 3.50% and 8.00%, with the highest year being 8.13% in 1997 (before the 42% Conrail purchase was completed). The latest year's rate of return is 3.91%. The five-year average rate of return was 5.47%, the three-year average rate of return was 4.09%, and the two-year average rate of return was 3.69%. We selected 4.50% as the appropriate average rate of return for use in measuring external obsolescence. This selection was based upon the most recent two years (with Conrail fully integrated) and considering general information regarding expected rates of return. If this 4.50% selected rate of return is compared with the investor required return of 11.70%, the Company's performance is 7.20% below the investor required return (11.70% - 4.50% = 7.20%). This 4.50% rate of return which is 7.20% lower than required cost of capital equates to a 61.54% external obsolescence factor (7.20% ÷ 11.70% = 61.54%).

Note: These computations have been made in accordance with the methodology presented in two authoritative textbooks quoted and discussed as follows:

The proper measurement for external (economic) obsolescence is stated by the Appraisal Institute as follows:

> Two methods can be used to measure external obsolescence. The appraiser should select the procedure that is best supported by market evidence. The appraiser can either 1) capitalize the income or rent loss attributable to the negative influence, or 2) compare sales of similar properties that are subject to the negative influence with others that are not. If pertinent sales data are abundant, the second procedure is preferred. However, an appraiser may encounter significant practical problems in attempting to account for other differences between the subject property and the comparable properties. Care should be exercised when this method is used.[14]

The computations made to derive the external obsolescence in this appraisal report relate to method number one (1) just quoted. These computations recognize that CSX Transportation Inc. has not earned its market required cost of capital on its total net investment in plant and equipment. (The primary causes for this below-market rate of return on all property are the intense level of competition and the high costs of doing business.)

The need for measuring obsolescence by the use of income data is discussed in *The Handbook of Advanced Business Valuation* as follows:

> A properly applied cost approach would have to consider both the functional and economic obsolescence of the assets. Both of these forms of obsolescence are measurable for the most part through an investigation of the earning capacity of the Facility....The analyst began with the income approach. This is because certain elements of

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[14] Appraisal Institute, *The Appraisal of Real Estate*, 10th ed., (Chicago: Appraisal Institute, 1992), 358.

> the income approach, such as rates of return, would also be needed in the application of the cost approach.[15]

This topic is further expounded upon in *Capitalization Theory and Techniques* as follows:

> The entire valuation process is comprised of integrated, interrelated, and inseparable procedures with the common objective of arriving at a convincing and reliable estimate of value. Although the approaches may be documented and explained on different pages of the appraisal report, they are rarely truly independent and unrelated. At times, the three approaches (if used) are so intertwined that some appraisers prefer the "one approach" concept and do not subscribe to the custom of separate presentations of the sales comparison approach, the income capitalization approach, and the cost approach.[16]

Specific treatment of the appraisal principles and techniques applicable to railroads and public utilities and businesses in the measurement of external obsolescence is further illustrated in the appraisal textbook entitled *The Valuation of Real Estate* as quoted on the following page.

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[15] Reilly, Robert F. and Schweihs, Robert P., *The Handbook of Advanced Business Valuation*, (New York: McGraw-Hill, 2000), 257.

[16] Charles B. Akerson, MAI, *Capitalization Theory and Techniques*, 2nd ed. (Chicago: Appraisal Institute, 2000), p. 6.

Most railroads and practically all public utilities incur a third and often severe loss in value due to external obsolescence. This loss in value, as demonstrated below under the cost approach to value, is caused by the difference in the *rate* of return allowed by regulatory agencies and the rate of return that the investment market indicates as competitive to attract a willing, able, and informed purchaser (investor).

The application of the cost approach to value is illustrated as follows:

Book value of gross plant		$250,500,250
Current assets		15,220,150
Construction work in progress		45,300,000
Materials and supplies		12,420,800
Total value of gross plant in operation		$323,441,200
Add: Depreciated value of leased properties		85,358,300
Total book value before depreciation		$408,799,500
Less: Accrued depreciation		
Physical - per book	$115,420,000	
External = 17.4% of depreciated plant value* or 0.174 x $293,379,500 =	51,048,033	
Total depreciation		$166,468,033
Value via cost approach		$242,331,467

* Depreciated plant value is difference between total book value — before depreciation of $408,799,500 and accrued physical book depreciation of $115,420,000 or $408,799,500 - $115,420,000 = $293,379,500

External depreciation is calculated as follows:

Market rate of capitalization	11.5%
Allowed rate of return	9.5%
Loss in earnings	2.0%

Loss in earnings of 2% ÷ market rate of 11.5% = 17.4% external obsolescence.[17]

[17] Alfred A. Ring and James H. Boykin, *The Valuation of Real Estate*, 3rd ed., (Englewood Cliffs, NJ: Prentice-Hall, 1986), 424.

The use of any other method of measuring obsolescence in the appraisal of the operating properties of railroad operating properties (other than the two methods quoted from the textbook of the Appraisal Institute) is not in agreement with generally accepted appraisal principles established by recognized appraisal authorities. By using the recognized appraisal principles for the measurement of obsolescence, the appraiser can generate a meaningful opinion of market value by the cost approach.

Not only is it necessary to adjust for external obsolescence in the appraisal process, it is unethical in practice to fail to investigate and take into account the loss in value resulting from external obsolescence. The following statement is from the *Uniform Standards of Professional Appraisal Practice* of the Appraisal Foundation.

> This guideline also requires the appraiser to investigate and take into account not only that loss of value that results from deterioration due to age but also loss of value due to functional and economic obsolescence. Economic obsolescence is a major consideration when assets are considered as parts of a going concern.[18]

Based upon the recognized and generally accepted methodology for the measurement of external obsolescence in the appraisal of railroad property as quoted above, the operating railroad property and equipment of CSX Transportation Inc. suffers an additional amount of external obsolescence of 61.54% due to the property's inability to earn a market rate of return currently. The cause of this inability to earn a market rate of return is primarily from external competitive, economic, and governmental sources. To adjust for external obsolescence an additional amount of $9,840,759,999

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[18] Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, (Washington, DC: Appraisal Foundation, 1992), S.R. 9-4(b), 43.

($15,990,835,227 x 61.54%) was deducted from the existing railroad property, plant and equipment. This computation results in my opinion of value by the cost approach of $6,150,075,228.

Thus, the indicated market value by the cost approach for CSX Transportation Inc. as of January 1, 2002, when rounded, was $6,150,000,000.

The Income Approach

The income approach is based primarily on the principle of anticipation and involves converting dollars of expected future income into present value. The execution of the income approach involves the selection of the appropriate capitalization method, estimation of the expected income, and estimation of a proper capitalization rate which matches the income to be capitalized. The basic income formula is shown in the box to the right.

$$Value = \frac{Income}{Rate}$$

Income-producing property is typically purchased for investment purposes, and the projected net income stream is the critical factor affecting its market value. An investor purchasing income-producing property is in effect trading a sum of present dollars for the right to a stream of future dollars. There is a relationship between the two, and the connecting link is the process of capitalization. Because future dollars are worth less than present dollars, the anticipated future dollars are discounted to a present worth on some basis that reflects the risk and the waiting time involved.

The income approach, which is related to investor thinking and motivation, is a basic tool for the valuation of income-producing property. It is based on the principle of anticipation reflected in the definition of value as the present worth of all the rights to future benefits accruing to ownership. These future benefits consist of some pattern of annual net income to the property.

The income approach is practical only when an income stream attributable to the property can be estimated. This income estimate may be developed and supported by comparisons with similar properties under similar circumstances

or based on a projection of a combination of historical data and current events leading to expectations for the future.

The income approach is one of the three approaches to value. The three approaches to value are not independent and unrelated to each other. It may be necessary to use elements of one approach in some portions of another approach. This is a natural part of the valuation process. Regarding the income approach the Appraisal Institute states:

> The income capitalization approach is one of three traditional approaches that an appraiser may use in the valuation process. However, it is not an independent system of valuation that is unrelated to the other approaches. The valuation process as a whole is composed of integrated, interrelated, and inseparable techniques and procedures designed to produce a convincing and reliable estimate of value, usually market value. The analysis of cost and sales data is often an integral part of the income capitalization approach, but capitalization techniques may be frequently employed in the cost and sales comparison approaches as well. For example, capitalization techniques are commonly used to analyze and adjust sales data in the sales comparison approach; in the cost approach, obsolescence is often measured by capitalizing an estimated rent loss.[19]

In the income approach for the operating property of a railroad company the present value of the future benefits of property ownership is estimated. This approach is particularly applicable to income producing companies where profit is the main motive for property ownership.

The typical investor's objective in any investment is to ultimately receive more than the amount invested. The inves-

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[19] Appraisal Institute, *The Appraisal of Real Estate*, 10th ed., (Chicago: Appraisal Institute, 1992), 409.

tor thus wants a complete return *of* all capital invested and in addition a fair return *on* the capital invested. Thus, the investor expects to completely recoup his investment and be fairly compensated for the use of his capital. The return *of* capital is usually referred to as the recapture of the initial capital investment. The return *on* capital is usually referred to as the compensation an investor receives for the use of his capital until it is recaptured.

In this appraisal we have used yield capitalization as the technique to produce the income approach to value indicator.

Yield Capitalization

Yield capitalization is a method of converting a series of income flows (called cash flows) into present value by discounting the expected future benefits at an appropriate discount rate (synonymous with the property's *overall yield rate* or *cost of capital*).

> To perform yield capitalization, an appraiser l) selects an appropriate holding period; 2) forecasts all future cash flows or cash flow patterns; 3) chooses an appropriate yield, or discount rate; and 4) converts future benefits into present value by discounting each annual future benefit or by developing an overall rate that reflects the income pattern, value change, and yield rate. The application of capitalization rates that reflect an appropriate yield rate, the use of present value factors, and discounted cash flow analysis are all yield capitalization procedures.[20]

Thus, the appraiser performs yield capitalization by either 1) discounting the cash flow to its present value for the duration of the income, or 2) capitalizing the appropriate income at an overall capitalization rate, which represents the income pattern, value change, and yield rate.

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[20] *Ibid.*, 483.

Upon projecting the amount, timing, and duration of the cash flows to the property being appraised, the appraiser must identify the pattern that the cash flow is expected to follow during the holding period. Those patterns are either a variable annuity, level annuity, increasing annuity, or decreasing annuity. For a level annuity where a property is expected to generate a level cash flow for a finite period of time and maintain its value during that period, the property can be valued with capitalization in perpetuity by dividing the periodic income by the appropriate discount rate. In this model the discount rate and the overall capitalization rate are the same.[21]

When the net income consists of a fixed amount that represents the return of capital (depreciation expense) plus a declining amount representing the return on the capital remaining in the investment, classic straight-line capitalization can be used to value the property.[22] In this model, as with the level perpetuity, the discount rate and the overall capitalization rate are the same.

If the cash flow pattern is expected to be in the form of a variable annuity each individual income flow will be discounted into an indication of present worth at the appropriate discount rate for the holding period. Further, the appraiser discounts any remaining value in the investment at the end of the holding period and adds the total present worth of the variable cash flows to the present worth of the future value at the end of the holding period. The total represents the present worth of the total property.

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[21] *Ibid.*, 490.

[22] *Ibid.*, 496.

The application of the DCF model for a variable annuity can be accomplished using the following formula.

$$Value = \frac{I_1}{(1+r)^1} + \frac{I_2}{(1+r)^2} + \frac{I_3}{(1+r)^3} + \ldots + \frac{I_n}{(1+r)^n}$$

In this formula, *I* equals income or cash flow in periods 1 through n, and *r* equals the discount rate. Where income has the characteristics of a perpetuity or of a classic straight line capitalization model, the universal capitalization formula, *Value = Income ÷ Rate*, can be used. In this case the overall capitalization rate will equal the discount rate.

Estimation of Income to Capitalize

The income level capitalized in yield capitalization is usually called cash flow. In fact, Dr. William Kinnard, MAI clarifies this in his appraisal textbook.

> "All of the annual 'income' figures used in appraising income-producing properties are *cash flows* rather than accrual accounting incomes."[23]

Cash flow can be defined in a number of ways, however for appraisal purposes it generally consists of income necessary to satisfy the cost of capital plus depreciation expense. Commercial and general appraisers recognize this level of income as simply *net operating income*. Railroad and utility appraisers know that the definition of "net operating income" for railroads, public utilities and commercial properties is different in one important aspect. For railroads and public utilities the level of income reported as "net operating income" is only that income available to pay the railroad or utility's cost of capital, while for commercial properties "net operating income" includes not only the level of income available for

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[23] William N. Kinnard, Jr., *Income Property Valuation*, (Lexington: Heath Lexington Books, 1982), 70.

debt and equity, but also the income to recapture a portion of the wasting asset (*otherwise known as depreciation expense*). For this appraisal of CSXT's operating property we have defined net operating income similar to the definition used by railroads and public utilities.

In general commercial appraisals cash flow is typically defined as simply net operating income, which is the income available for debt and equity plus the depreciation expense. For an illustration of this type of analysis, refer to *The Appraisal of Real Estate*, 11th edition, page 564.

For unit concept appraisals cash flow is often defined as net operating income (defined as the income available to pay the cost of capital) plus depreciation expense and the current portion of deferred income taxes. This definition of cash flow is sometimes referred to as *gross cash flow* because there is no deduction for capital expenditures to keep the unit operating, Thus, this cash flow model will have a limited life duration. In other words, gross cash flows cannot continue indefinitely without significant new investment to keep the railroad operations ongoing.

Another variation of this same general definition of cash flow is called *net cash flow*, which is the gross cash flow less capital expenditures. Some refer to this as gross revenue less all cash expenses except interest expense. For the appraisal of railroad operating properties where it is assumed that the amount of capital reinvestment is equal to the depreciation expense, *net cash flow* can be defined simply as net operating income. (*Note: For the typical railroad such as CSXT, capital expenditures will almost always exceed the annual depreciation expense resulting in a growing capital asset base. However, for the ad valorem tax appraisal of the typical railroad we can conservatively assume that the capital expenditures equal the depreciation expense resulting in a static level of investment indefinitely. The basis for this reasoning is that we are only appraising the existing level of assets at the date*

of the appraisal for property tax purposes.) For the appraisal of a railroad operating property as a going concern, net cash flow may be the easiest level of income to work with. To estimate the net cash flow for railroad operating properties in yield capitalization generally the same methods used to estimate net operating income may be employed.

It is critical to remember, using net operating income as a surrogate for net cash flows implies that there will be no growth in railroad properties as a result of capital expenditures in excess of the annual level of depreciation expense. While this may seem at odds with what is actually happening with CSXT's operating properties, it is irrelevant to the appraisal problem. The appraiser may appraise the current level of operating property by assuming no growth or decline in overall net investment. Assuming that all new capital investment simply earns its cost of capital, new growth in assets in the future will not impact the current value of the existing assets subject to appraisal. From an appraisal standpoint, it does not matter. One may simply estimate the market value of the current level of assets assuming a level income for the unit discounted at the current cost of capital or by assuming an increasing income (propelled by reinvesting in more assets than are currently in existence at the appraisal date). If the appraiser uses a growing level of income for discounting to current market value, it is appropriate to use net cash flow which will typically be lower than the current net operating income and the appropriate discount rate will be the cost of capital rate less the expected growth in overall value. Either method is acceptable. [*It should be noted by the reader that for the next several years, like the last several years, CSXT is expected to have capital expenditures, which exceed depreciation expenses and would tend to lead to annual growth in the net investment base. The vast majority of the capital expenditures currently and expected for the future are to replace infrastructure assets currently in existence.*] For this appraisal we have assumed a level net

cash flow projection discounted at the cost of capital rate. Thus, we have used our estimate of expected levelized net operating income as a surrogate for net cash flow to discount.

The Capitalization Rate

The capitalization rate to use in yield capitalization is known by several different names — *cost of capital rate,* the *weighted average cost of capital,* the *discount rate,* and the *overall yield rate.* All of these terms are synonymous with the rate of return on total capital and are proper to use in yield capitalization. The Appraisal Institute defines the overall yield rate as follows:

> The *overall yield rate* (Y_o) is a rate of return on the total capital. It represents a weighted average of the equity yield rate and the mortgage yield rate.[24]

Thus, the discount rate can be estimated by the use of one of the same methods as used in direct capitalization which is the band of investment technique. The band of investment technique using the yield rates for debt and equity produces the weighted average cost of capital which is the appropriate discount rate in yield capitalization. Further, if the income in yield capitalization represents a perpetuity with no change in value or if the income has the characteristics of straight line capitalization, all of the techniques used in direct capitalization to obtain the overall capitalization rate will be valid for estimating the overall yield rate because, as discussed earlier, in those circumstances the overall capitalization rate and the overall yield rate will be equal.

Further, to derive *equity yield rates* from market information yield capitalization permits some things that would not be proper using direct capitalization. For example, appraisal texts record how it is permissible to use stocks and bonds for

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[24] *The Appraisal of Real Estate*, 10th ed., (Chicago: Appraisal Institute, 1992), 426.

determination of equity yield rates in alternative investments when appraising real estate.

> An investor may compare the expected equity yield on a real property investment with the yields on alternative investments with commensurate risk (e.g., stocks and bonds) and with a lender's yield on mortgages secured by similar real property.[25]

The Appraisal Institute goes on to state:

> To estimate equity yield rates, appraisers must do market research. This research can take many forms and may include one or more of the following analyses. . . Comparison with the equity yield rates achieved in alternative investments of comparable risk such as stocks and bonds . . .[26]

When using any capitalization method, the reliability of the income approach is dependent upon the reasonableness of the estimate of anticipated future income and the capitalization rate. The first area of concern is estimating the income to be capitalized and the quantity, quality, and duration of the income. The second area of concern is estimating a proper rate of capitalization.

The computations showing actual net operating income and a variety of averages and trends in net operating income are on the following page. In addition, the capitalization computations based on the estimated future net operating income (a liberal surrogate for the net cash flow of CSXT) and the proper capitalization rate (discount rate) are shown.

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[25] *The Appraisal of Real Estate*, 11th ed., (Chicago: Appraisal Institute, 1996), 554.

[26] *Ibid.*, 555.

CSX TRANSPORTATION, INC.
Indication of Value by Income Approach
January 1, 2002

Year	Net Operating Income*	Weighting	Product
1997	$877,000,000	1	$877,000,000
1998	781,000,000	2	1,562,000,000
1999	684,000,000	3	1,992,000,000
2000	542,000,000	4	2,168,000,000
2001	622,000,000	5	3,110,000,000
Average	$697,200,000	15	$9,709,000,000
	5-Year Weighted Average =		$647,266,667
	3-Year Weighted Average =		$602,333,333

2001 Net Operating Income	$622,000,000
2-Year Average Net Operating Income	582,000,000
5-Year Average Net Operating Income	697,200,000
5-Year Wtd. Adjusted Net Oper. Income	647,266,667
3-Year Wtd. Average Net Oper. Income	602,333,333
Discounted Least Squares Regression (DF=0.80)	571,012,312
Discounted Least Squares Regression (DF=0.60)	581,323,857

Estimated Future Net Cash Flow	$700,000,000
Discount Rate	11.70%
INDICATED VALUE BY INCOME APPROACH	$5,982,905,983
(Rounded)	$5,983,000,000

* NOI from Annual Supplement to CSX Corporation Annual Report (Rail).

Explanation of Income Approach

Determination of Net Cash Flow to be Capitalized

Our efforts to estimate the future cash flow to be derived from CSXT's properties as they existed as of the appraisal date centered primarily on projected and anticipated future net operating income estimates as a surrogate for net cash flow. As mentioned on page 33, net operating income can be considered as an estimate of net cash flow for use in yield capitalization where it is expected that the income will have the characteristics of a level perpetual income stream or the characteristics indicative of classic straight line capitalization. Straight line capitalization is appropriate when 1) recapture is based on equal annual amounts, 2) the return on investment is

expected to be a percentage of the undepreciated balance of the investment, and 3) the income is expected to decline as the property ages.

We considered income information for the last several years, economic cycles in the railroad industry, simple and weighted averages, trend analysis, and income based on projections after considering Company provided data. Our income projections were based on the income statements provided in the Supplement to the Annual Report for CSX Corporation. Upon discussions with CSX personnel we believe that the rail income data provided in this document provides us with the best indication of income data for our appraisal of CSXT. We believe the income data from the latest two years before the appraisal date provide the most meaningful income figures. This is because the Conrail operations were reflected in the results for these two years. The reported net operating income for the year ended December 31, 2001 was $622,000,000. [This is calculated by deducting the income tax expense of $121 million from the Rail Operating Income Before Fees & Special Items of $743 million.] The two-year average, five-year average, and five-year weighted average adjusted net operating incomes computed in the same manner were $582,000,000, $697,200,000, and $647,266,667 respectively.

CXST pays a fee to CSX Corp for the provision of most of its management functions. CSXT also pays a fee to CSX Technologies for the provision of all of its technology requirements. During the years leading up to December 31, 2001 those fees were broken into two portions; a portion which contained only the actual cost of providing the service (Tier 1), and the portion which represented a profit to the provider (Tier 2). When the company reports the results of its rail segment, it treats the Tier 2 portion (the profit) of both of those fees as if it were not an operating expense. This is the management view shown in the Supplemental Report to the

Annual Report for rail purposes. We have concluded that like the company we will consider future cash flows by treating only the Tier 1 portion of those fees as ordinary sustainable operating expenses.

CSXT has experienced significant volatility in the net operating income throughout its entire history, and, in fact, the entire railroad industry in general has experienced wide fluctuations in this regard. The latest two years operating results are most indicative of the current earnings capabilities of the Company because the Conrail operations are included in the rail income figures. With high fuel prices, potential economic and labor woes, and railroad industry volatility, we expect the levelized net cash flow on a going-forward basis to be in the $700,000,000 range. Our estimate of future stabilized income (net cash flow) includes a cushion to cover our expectations of future income growth, other miscellaneous income from railroad operations and any residual income adjustment for operating lease benefits. Our estimate of long-term level net cash flow takes into consideration the investment that CSXT has committed to its business, the economics of the railroad industry, and the long-time turbulent fluctuation in CSXT's operating income.

After consideration of all the factors pertinent to the estimation of future income for CSX Transportation Inc., it is believed that the property existing at the appraisal date will produce levelized net cash flow of approximately $700,000,000. Our future net cash flow estimate of $700,000,000 includes an estimate of income for construction work in progress and the impact of all operating leased property used by the Company, other miscellaneous income from railroad operations, as well as growth from the current level of earnings. We have considered the best information available from published materials provided by Company officials along with historical earnings and net cash flow projections.

Income Approach Calculation

Utilizing the income approach formula, income divided by rate equals value, we divided the estimated net operating income by the cost of capital to obtain the market value by the income approach. When the estimate of future income is capitalized at the proper discount rate of 11.70%, the indication of value by the income approach was $5,982,905,983. Thus, as of January 1, 2002 our indication of market value for the operating property of CSXT by the income approach was $5,983,000,000. Detailed explanation of the derivation of the cost of capital follows.

The Cost of Capital (Discount Rate)

The estimated cost of capital in this report for CSX Transportation Inc. as of January 1, 2002 is based on the generally accepted appraisal methodology known as the band of investment technique. The band of investment technique consists of the following steps:

1. Analyze and determine the appropriate capital structure.
2. Identify the appropriate cost for each financing band of the capital structure.
3. Weight the appropriate cost for each financing band by the relative proportion of the capital structure represented by each financing band.

The sum of the weighted costs for the financing bands represents the weighted average cost of capital. This weighted cost of capital is typically known as the discount rate in appraisal literature and the algebraic formula is shown in Figure 1.

$$K = (D \times D_r) + (E \times E_r)$$

where

K = Weighted Average Cost of Capital
D = Proportion of Debt in Capital Structure
D_r = Cost of Debt
E = Proportion of Equity in Capital Structure
E_r = Cost of Equity

Figure 1

In explaining the estimation of the cost of capital, Ibbotson Associates states:

> The cost of capital is always an expectational or forward-looking concept. While the past performance of an investment and other historical information can be a good guide and is often used to estimate the required rate of return on capital, the expectations of future events are the only factors that actually determine the cost of capital. (An investor contributes capital to a firm with the expectation that the business's future performance will provide a fair return on the investment. If past performance were the criterion most important to investors, no one would invest in startup ventures.)[27]

The cost of capital for CSX Transportation Inc. as of January 1, 2002 is estimated to be 11.72% (rounded to 11.70%) as the chart below indicates. Following the chart are explanations of the derivation of each of the component parts.

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[27] *SBBI (Stocks, Bonds, Bills and Inflation)*, 1997 Yearbook, (Chicago: Ibbotson Associates, 1997), 143.

Corp Tax Rate 38.00%				Flotation Cost Adjustment			
Capital	Portion	Cost	Product	Flot. Cost	Division	Adj Cost	Product
Debt	40.00%	8.05%	3.22%	1.00%	99.38%	8.10%	3.24%
Equity	60.00%	13.50%	8.10%	4.50%	95.50%	14.14%	8.48%
Totals	100.00 %		11.32%				11.72%

In the computations above the sum of the products obtained by multiplying the respective portions of the capital structure represented by debt and equity times their respective rates is the cost of capital rate. The use of the band of investment method with the mortgage and equity components is a very practical method which can be used in the appraisal of railroads and public utilities. It is also exactly the same method and type of calculation made by regulatory commissions when setting the authorized rate of return for those public utilities which are operating under rate of return regulation and the Surface Transportation Board when determining adequacy of revenues for railroads.

Capital Structure

Economists and appraisers measure a firm's capital structure in terms of the market values of its debt and equity because that is the best measure of the amounts of debt and equity that investors have invested in the company on a going-forward basis. Furthermore, economists and appraisers generally agree that the goal of management is to maximize the value of the firm, where the value of the firm is the sum of the market value of the firm's debt and equity. Only by measuring a firm's capital structure in terms of market values can its managers choose a financing strategy that maximizes the value of the firm.

As the operating environment of railroad companies evolves into a consistently more competitive posture, investors and analysts are finding other fundamentals changing and appraisers must acclimate appraisal procedures to those changes. Appraisers involved in the appraisal of railroads must be aware of the evolutionary processes occurring within the industry and consider their effects on the valuation process. We must rely on generally accepted appraisal principles and utilize market capital structures when estimating the cost of capital for CSX Transportation Inc.

For estimating the cost of capital for CSX Transportation Inc. it is appropriate to use the typical market capital structure for similar railroad companies. There is very little debate about this concept, however for clarity we note the following statement from Brigham and Gapenski.

> We are absolutely convinced that the procedures we recommend are correct — namely, firms should focus on market value capital structures and base their cost of capital calculations on market value weights. Because market values do change, it would be impossible to keep the actual capital structure on target at all times, but this fact in no way detracts from the validity of market value targets.[28]

It is also important to note what elements of capital comprise the makeup of the *capital structure* from an appraisal standpoint. For appraisal purposes, the capital structure consists only of long-term debt, common stock, and where appropriate, preferred stock. The capital structure should not be confused with *financial structure* or any other term used in financial literature. To understand what elements comprise the capital structure it is important to define capital structure and *financial structure*, which are defined as follows:

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[28] Eugene F. Brigham and Louis C. Gapenski, *Financial Management*, 7th ed. (New York: The Dryden Press, 1994), 599.

> CAPITAL STRUCTURE corporation's financial framework, including LONG-TERM DEBT, PREFERRED STOCK, and NET WORTH. It is distinguished from FINANCIAL STRUCTURE, which includes additional sources of capital such as short-term debt, accounts payable, and other liabilities.[29]
>
> FINANCIAL STRUCTURE makeup of the right-hand side of a company's BALANCE SHEET, which includes all the ways its assets are financed, such as trade accounts payable and short-term borrowings as well as long-term debt and ownership equity. Financial structure is distinguished from CAPITAL STRUCTURE, which includes only long-term debt and equity.[30]

It is also important to note that neither accumulated depreciation nor accumulated deferred income taxes are included in capital structure. Some appraisers have mistakenly included accumulated deferred income taxes in constructing a firm's capital structure. This is simply wrong for estimating the cost of capital and for appraisal purposes. The following quotation addresses this issue quite well:

> Since depreciation-generated funds have the same cost as the firm's WACC when retained earnings are used for the equity component, it is not necessary to consider them when estimating the WACC...Therefore, deferred taxes, like depreciation, have a cost equal to the firm's WACC using retained earnings as the equity component. Indeed, deferred taxes arise solely because a firm records a different depreciation expense on its tax books than on the books used to report income to shareholders. . . Deferred taxes are treated the same way as

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[29] John Downes and Jordan Elliot Goodman, *Dictionary of Finance and Investment Terms*, (New York: Barron's, 1985), 54.

[30] *Ibid.*, 132.

> depreciation cash flows: they are not included when estimating the firm's WACC. . . [31]

The appropriate capital structure for use in estimating CSX Transportation Inc.'s cost of capital is the expected capital structure that a typical purchaser would likely use to finance the purchase of the operating assets of the Company. Thus, an analysis of the typical market capital structure used in the railroad industry is appropriate. The market capital structure developed for CSX Transportation Inc. was calculated from information obtained from *The Value Line Investment Survey* and *Standard & Poor's Research Insight* data bases as of January 2002. The capital structure analysis was made by considering the capital structures of the several groups of companies in the railroad industry. The average and median capital structures of the Value Line railroad industry (all 10 companies with traded stock) were approximately 40% debt and 60% equity using both *Value Line* and *Standard & Poor's* data. Additionally, the capital structures of the large railroad companies (annual sales of over $2.5 billion) were approximately 40% debt and 60% equity using both *Value Line* and *Standard & Poor's* data. Our selection of a market capital structure of 40% debt and 60% equity may be considered slightly conservative, in view of the fact that CSX and Norfolk Southern have been recently involved in consolidations requiring the taking on of large amounts of long-term debt. The capital structure calculations are shown on the following pages.

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[31] Eugene F. Brigham and Louis C. Gapenski, *Financial Management*, 7th ed. (New York: The Dryden Press, 1994), 368-369.

Capital Structure - January 1, 2002
Value Line Railroad Industry (All) - Value Line Data

Company Name	Ticker	LTD%	PS%	CS%
Burlington Northern	BNI	37.53%	0.00%	62.47%
CSX Corp.	CSX	42.82%	0.00%	57.18%
Florida East Coast	FLA	22.71%	0.00%	77.29%
Kansas City South'n	KSU	45.49%	0.43%	54.08%
Norfolk Southern	NSC	49.71%	0.00%	50.29%
Pioneer Railcorp	PRRR	69.12%	0.00%	30.88%
Providence & Worcester R R	PWX	0.00%	0.00%	100.00%
RailAmerica Inc.	RRA	56.44%	0.00%	43.56%
Union Pacific	UNP	40.61%	0.00%	59.39%
Genesee & Wyo Inc	GNWR	27.28%	6.04%	66.68%
	Average	39.17%	0.65%	60.18%
	Median	41.71%	0.00%	58.29%

Source: Value Line Data Base, January 2002.

Capital Structure - January 1, 2002
Value Line Railroad Industry (Large) - VL Data

Company Name	Ticker	LTD%	PS%	CS%
Burlington Northern	BNI	37.53%	0.00%	62.47%
CSX Corp.	CSX	42.82%	0.00%	57.18%
Norfolk Southern	NSC	49.71%	0.00%	50.29%
Union Pacific	UNP	40.61%	0.00%	59.39%
	Average	42.67%	0.00%	57.33%
	Median	41.71%	0.00%	58.29%

Source: Value Line Data Base, January 2002.

Capital Structure - January 1, 2002
Value Line Railroad Industry (All) - S&P Data

Burlington Northern Santa Fe	BNI	36.29%	0.00%	63.71%
CSX Corp	CSX	43.10%	0.00%	56.90%
Florida East Coast Inds	FLA	22.78%	0.00%	77.22%
Genesee & Wyoming Inc -Cl A	GNWR	25.74%	5.68%	68.58%
Kansas City Southern Inds	KSU	43.35%	0.41%	56.24%
Norfolk Southern Corp	NSC	49.99%	0.00%	50.01%
Pioneer Railcorp -Cl A	PRRR	69.25%	0.00%	30.75%
Providence And Worcester Rr	PWX	0.00%	0.11%	99.89%
RailAmerica Inc	RRA	55.89%	0.00%	44.11%
Union Pacific Corp	UNP	40.67%	0.00%	59.33%
	Average	38.71%	0.62%	60.67%
	Median	41.89%	0.00%	58.12%

Source: S&P Research Insight CD Rom, January 2002.

Capital Structure - January 1, 2002
Value Line Railroad Industry (Large) - S&P Data

Burlington Northern Santa Fe	BNI	36.29%	0.00%	63.71%
CSX Corp	CSX	43.10%	0.00%	56.90%
Norfolk Southern Corp	NSC	49.99%	0.00%	50.01%
Union Pacific Corp	UNP	40.67%	0.00%	59.33%
	Average	42.51%	0.00%	57.49%
	Median	41.89%	0.00%	58.12%

Source: S&P Research Insight CD Rom, January 2002.

Cost of Debt

The expected return on debt, or the cost of debt capital (D_r) is the rate that investors would incur when financing the purchase of the operating assets of CSX Transportation Inc. It is the appropriate debt rate for the cost of capital and is relatively simple to estimate. Unlike the cost of equity, the required return on debt is directly observable in the market. It is best approximated by the current yield-to-maturity (yield) on the applicable debt. Often an average of recent yields is also used. The yield exemplifies the market's expectation of future returns. If the market's expectations of future debt returns

were different from those implicit in the price, the market price of the debt would be bid up or down so that the market's expectations were reflected in the price.[32]

From information in *Mergent's Bond Record* (January, 2002), we found the *Mergent's* bond rating to be *Baa2* for CSX Corporation.[33] We also found the *Standard & Poor's* long-term debt rating for CSX Corporation to be *BBB* as of January 1, 2002. *Mergent's Bond Record* reports Utility Bond Yields for "Baa" rated debt to be *8.27%*, Corporate Bond Yields for "Baa" rated debt to be *8.05%*, and Industrial Bond Yields for "Baa" rated debt to be *7.82%* at the end of December 2001. From this information we determined the appropriate cost of debt capital for CSX Transportation Inc. to be *8.05%* as of January 1, 2002.

Cost of Equity

In estimating the cost of equity capital, several methods are employed. The market cost of equity is often considered to be the most difficult part of computing the cost of capital because it relies on interpretation of projections by market analysts as well as the projections of the equity models used by the appraiser. The market cost of equity is equal to the *expected* rate of return for a company's equity. There are several methods used to estimate the cost of equity capital. The most common methods are the discounted cash flow method (DCF), the risk premium method (RP), and the capital asset pricing model (CAPM).

All estimates of the cost of equity rates fall into one of two classes. They are either (1) add-ons to an interest rate, or (2) ratios of return to investment. Add-on estimates of the

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[32] Eugene F. Brigham and Louis C. Gapenski, *Financial Management*, 7th ed. (New York: The Dryden Press, 1994), 147.

[33] We also noted that *Mergent Bond Record* reports Louisville & Nashville Railroad (one of the predecessors to the subject company) bonds due in 2003 are rated Baa1.

cost of equity capital include RP and the CAPM. The DCF method is a ratio of return to investment. After computing the cost of equity by the DCF, RP, and CAPM methods, the data was analyzed and reconciled to obtain the cost of equity capital of 13.50% prior to adjustment for flotation costs. This equity rate was determined after studying and analyzing much data, some of which is included in the addendum of this report. In considering this information we were aware that more risk is involved with the equity position than the debt position, thereby demanding a higher return for equity than debt. We will discuss the calculations employed in each method.

DCF Method

The discounted cash flow method of estimating the cost of equity is based on the formula shown in Figure 2. Our computations using the DCF method are based upon information from the *Standard and Poor's Research Insight* database, *Institutional Brokers Estimate System* (IBES) and the *Value Line Investment Survey* database. We began our analysis by screening the Standard and Poor's database for com-panies with approximately equal risk to the risk of CSX Transportation Inc. Further, we performed additional DCF analyses on two other groups of companies, all *Value Line* railroads and the Value Line large railroads (annual sales over $2.5 billion). We used two sets of growth estimates for all of the groups of companies. The growth estimates considered were provided by the Institutional Brokers Estimate System (IBES) and the *Value Line Investment Survey.*[34] From these analysts' projections we calculated DCF indicators on all groupings and calculated a simple average and a median of the indicators. We believe the appropriate cost of equity for

[34] The Institutional Brokers Estimate System (IBES) is a database provided through *Standard & Poor's Research Insight* of earnings expectations obtained from more than 3,500 security analysts from over 300 contributing firms.

CSX Transportation Inc. by the DCF method is 13.75% as of January 1, 2002.

$$K_e = \frac{D_1}{P_0} + g$$

where

K_e = *Cost of equity*
D_1 = *Expected Dividend in year* 1
P_0 = *Current price of stock*
g = *Growth in dividends*

Figure 2

Risk Premium Method

The risk premium method is a standard method of estimating the cost of equity (K_e) based on the formula in Figure 3. This method sums two elements of risk — a risk free rate, which is the price of time (the reward for deferring consumption and for not exposing funds to risk), and a risk premium, which is the additional reward for assuming risk. The nominal risk free rate includes the real risk free rate and an inflation premium. The risk premium includes an interest rate risk, business risk, financial risk, and liquidity risk. All of these elements are included when calculating equity cost by the risk premium method.

$$K_e = R_f + R_p$$

where

K_e = *Cost of equity*
R_f = *Risk free rate*
R_p = *Risk premium*

Figure 3

Our risk premium calculations included computations for two categories of risk premium indicators — general indicators and indicators by the same groups used in our DCF analysis. Our risk premiums were derived from the 2002 edition of *Stocks, Bonds, Bills and Inflation* (SBBI), published by Ibbotson Associates. The SBBI risk premium was cross-checked for reasonableness by information from *Value Line*.[35] Our relevant current 'safe rates' for the general indica-

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[35] In an effort to check the long-term risk premium of 7.4% from SBBI published by Ibbotson Associates, Inc., we performed our own calculations to confirm or deny the reasonableness of this figure. The SBBI risk premium figure is supported by our own calculations of risk premium by using the CAPM formula in Figure A. From *Value Line* we know the market average return on all the stocks in their database is 14.18% and that the 5-year beta is 0.89 for the full database (see statistics for full database, *Value Line* CD ROM, January 2002). Further, we know the long-term treasury bond rate is 5.86% at January 1, 2002. Therefore, we can substitute all the known elements into the CAPM formula and solve for RP as shown in Figure B. The result of this calculation is a risk premium indicator of 9.35%, which more than supports the SBBI long-term government bond risk premium of 7.4%.

$$K_e = R_f + \beta(R_p)$$

Figure A

Solve for R_p

$$R_p = \frac{K_e - R_f}{\beta}$$

$$R_p = \frac{0.1418 - 0.0586}{0.89}$$

$$R_p = 0.0935$$

Figure B

tors were derived from the sources footnoted below.[36] The 'safe rates' used for each company within the company groupings were the average yields to maturity for the company quoted in *Mergent's Bond Record* (January, 2002). The average yield to maturity for each company's bonds was added to the SBBI corporate bond risk premium to obtain an individual estimate for each company in the group. Thus, the risk premium indicators for the individual groups are specific for each company within the group and, thus, as individualized as possible for each company.

The range for all calculations using the risk premium method indicates the cost of equity to be between 10.5% and 13.4% for the general indicators and between 13.73% and 14.27% for the risk premium indicators by company groupings.

As with the DCF analysis, we calculated the simple average and median for each of the groupings of companies identified earlier. We believe the appropriate cost of equity for CSX Transportation Inc. by the risk premium method is 13.75% as of January 1, 2002. A summary of the risk premium indicators and the supporting data is in the Addendum Section.

Capital Asset Pricing Model

The capital asset pricing model (CAPM) is a generally accepted method of estimating the cost of equity (K_e) based on the formula shown in Figure 4. The CAPM method is much like the risk premium method, however the risk premium is adjusted by beta before it is added to the appropriate risk level. The two elements of risk are a risk free rate, which is the price of time (the reward for postponing consumption and for not exposing funds to risk), and a risk premium,

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[36] Ibbotson & Associates, 2002 SBBI & Risk Premia over Time Report 2002 and the Federal Reserve, January 2, 2002.

which is the additional compensation for assuming risk. The nominal risk free rate includes the real risk free rate and an inflation premium. The risk premium includes an interest rate risk, business risk, financial risk, and liquidity risk. All of these elements are accounted for when we calculated the cost of equity using the CAPM method.

$$K_e = R_f + \beta R_p$$

where

K_e = *Cost of equity*
R_f = *Risk free rate*
β = *Beta*
R_p = *Risk premium*

Figure 4

Our CAPM calculations included computations for the same groups used in our DCF analysis. Our 'safe rates' for the CAPM calculations were derived as described in the risk premium method discussed earlier. Our beta estimate was based on observing the average and median *Value Line* betas from the large railroad companies which are believed to be most similar in operating characteristics and business and financial risk to the subject railroad. The average and median betas for this group and are shown in Figure 5. Our risk premiums were derived from the 2002 edition of SBBI. Finally, we calculated a forward-looking (*Ex Ante*) CAPM indicator by deriving an expected risk premium from the S&P 500 companies. The *ex ante* CAPM indicator is a good check on the reliability of the standard CAPM because it is forward looking.

Group of Companies	Avg. Beta	Med. Beta
VL Large Railroads	1.00	1.00

Figure 5

All prospective investment in railroad companies is based on an expectation of future benefits. This is consistent with the fundamental principle underlying the income approach which is the principle of anticipation. In order to perform the *ex ante* CAPM indicator we derived the expected cost of equity for the companies making up the S&P 500 (which are expected to pay dividends). We developed the weighted average (weighted by market value) for the S&P 500, which was 14.76%. We believe this market weighted average is appropriate because the monthly fundamental beta is estimated based upon the sensitivity of a company's stock price to the overall fluctuation in the Standard & Poor's 500 (S&P 500) Index Price (with the S&P 500 being the surrogate for the market in general). The market weighted average gives most weight to the highest market value stocks and is a very good indicator of the central tendency of the overall market cost of capital.

The general CAPM indicators, using the risk premium from SBBI published by Ibbotson Associates, Inc. and our representative railroad industry beta of 1.00, indicates a cost of equity capital of approximately 13.00% (giving the most consideration to the long-term government bond indicator). The company specific CAPM indicators computed and published by *Standard & Poor's Research Insight* uses the S&P beta for each company we have listed in the study and indicates a cost of equity for of approximately 11.15%.[37] These indicators are *ex post* or based on historical facts. Again, to help determine the reasonableness of these general and specific historical indicators we also computed an *ex ante* or forward-looking CAPM indicator. The ex ante CAPM was 14.76%.

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[37] *The Standard & Poor's* Capital Asset Pricing Model (CAPM) is computed independently by *Standard & Poor's* as a part of their *Research Insight* service and is a method of determining the expected rate of return for an asset at a given level of risk.

Based upon the analysis presented and considering all the relevant facts we believe the appropriate cost of equity capital indicated by the CAPM method is 13.25% as of January 1, 2002 for CSX Transportation Inc. A summary of the CAPM indicators and the supporting data can be found in the addendum. After determining a proper rate for both debt and equity we utilized the band of investment technique to calculate an indicated capitalization rate of 11.32% before adjustment for flotation costs.

Flotation Cost Adjustment

Flotation costs are the costs associated with issuing debt and equity. They are made up of several kinds of costs including underwriter's fees, legal expenses, cost of preparing the prospectus, etc. Flotation costs can be accounted for either by amortizing the cost (reducing the cash flow to discount), or by including them in the cost of capital. Many studies have been made regarding the amount of flotation costs for debt and equity capital.[38]

All of these studies essentially reach the conclusion that a flotation cost adjustment must be made when estimating the cost of capital (even when no additional securities are expected to be issued). The following illustration is quoted by Roger A. Morin, PhD, *Regulatory Finance: Utilities' Cost of Capital,* (Arlington, VA: Public Utilities Reports, Inc., 1994), p. 170.] and fully addresses this issue.

> Brigham, Aberwald, and Gapenski (1985) performed an excellent analysis regarding the need for a flotation cost adjustment. The following illustration adapted from

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[38] See Brigham and Gapenski, *Financial Management Theory and Practice*, 7th ed., (Dryden Press: New York), 869., Richard H. Pettway, "A Note on the Flotation Costs of New Equity Capital Issues of Electric Companies," *Public Utilities Fortnightly*, March 18, 1982, and Jay R. Ritter, "The Costs of Going Public," *Journal of Financial Economics*, December 1987.

Brigham, Aberwald, and Gapenski (1985) shows that: (1) even if no further stock issues are contemplated, the flotation adjustment is still permanently required to keep shareholders whole, and (2) flotation costs are only recovered if the rate of return is applied to total equity, including retained earnings, in all future years, even if no future financing is contemplated.

The flotation cost adjustment process is shown here in Tables 6-1 through 6-3 using illustrative market data.

The assumptions used in the computation are shown in Table 1. The stock is selling in the market for $25, and investors expect the firm to pay a dividend of $2.25, which will grow at a rate of 5% thereafter. The traditional DCF cost of equity is thus k = D/P + g = 2.25/25 +.05 = 14%, or $3.50 in the first year. Nine percent of the 14%, or $2.25, will come from dividends, so that the remaining 5%, or $1.25, must then come from capital gains. To get a capital gain of $1.25 from $1.188 of retained earnings, the earnings retained must clearly earn more than 14%. Therefore, if the firm sells me a share of stock incurring a flotation cost of 5%, the traditional DCF cost of equity adjusted for flotation cost is thus ROE = D/P(1-f) + g =.09 /.95 +.05 = 14.47%

TABLE 6-1
ASSUMPTIONS

Issue Price =	$25.00
Flotation Cost =	5.00%
Dividend Yield =	9.00%
Growth =	5.00%
Equity Return = (D/P + g)	14.00
Allowed Return on Equity = (D/P(1 -f) + g)	14.47%

Table 6-2

1	$23.75	$0.00	$23.75	$25.00	1.0526	$3.44	$2.25	65.45%
2	23.75	1.19	24.94	26.25	1.0526	3.61	2.36	65.45%
3	23.75	2.43	26.18	27.56	1.0526	3.79	2.48	65.45%
4	23.75	3.74	27.49	28.94	1.0526	3.98	2.60	65.45%
5	23.75	5.12	28.87	30.39	1.0526	4.18	2.73	65.45%
6	23.75	6.56	30.31	31.91	1.0526	4.39	2.87	65.45%
7	23.75	8.08	31.83	33.50	1.0526	4.61	3.02	65.45%
8	23.75	9.67	33.42	35.18	1.0526	4.84	3.17	65.45%
9	23.75	11.34	35.09	36.94	1.0526	5.08	3.32	65.45%
10	23.75	13.09	36.84	38.78	1.0526	5.33	3.49	65.45%
		Growth(%) =	5.00	5.00		5.00	5.00	

Table 6-2 above demonstrates that only if the company is allowed to earn 14.47% on total equity (Column 3) will investors earn their cost of equity of 14%. Column 1 shows the initial common stock account, while Column 2 shows the cumulative retained earnings balance, starting at zero, and steadily increasing from the retention of earnings. Total equity in Column 3 is the sum of common stock capital and retained earnings. The stock price in Column 4 is obtained from the seminal DCF formula: D /(k - g). Earnings per share in Column 6 is simply the allowed return of *14.47%* times the total common equity base. Dividends start at $2.25 and grow at 5% thereafter, which they must do if investors are to earn a 14% return. The dividend payout ratio remains constant, as per the assumption of the DCF model. All quantities, stock price, book value, earnings, and dividends grow at a 5% rate.

Only if the company is allowed to earn 14.47% on equity do investors earn 14%. For example, if the company is allowed only 14%, the stock price drops from $26.25 to $26.13 in the second year, inflicting a loss on shareholders. This is shown in *Table 3*. The growth rate drops from 5% to 4.53%. Thus, investors only earn 9% + 4.53% = 13.53% on their investment. *It is noteworthy that the adjustment is always required each and every*

year, whether or not new stock issues are sold in the future, and that the allowed return on equity must be earned on total equity, including retained earnings, for investors to earn the cost of equity.[39]

Table 6-3

Year	Book Value	Earnings	Retained Equity	Total Stock Equity	Market/Book Ratio	EPS	DPS	Payout
1	$23.75	$0.00	$23.75	$25.00	1.0526	$3.33	$2.25	67.67%
2	23.75	1.08	24.83	26.13	1.0526	3.48	2.35	67.67%
3	23.75	2.20	25.95	27.31	1.0526	3.63	2.46	67.67%
4	23.75	3.37	27.12	28.55	1.0526	3.80	2.57	67.67%
5	23.75	4.60	28.35	29.84	1.0526	3.97	2.69	67.67%
6	23.75	5.88	29.63	31.19	1.0526	4.15	2.81	67.67%
7	23.75	7.23	30.98	32.61	1.0526	4.34	2.93	67.67%
8	23.75	8.63	32.38	34.08	1.0526	4.53	3.07	67.67%
9	23.75	10.09	33.84	35.62	1.0526	4.74	3.21	67.67%
10	23.75	11.62	35.37	37.24	1.0526	4.95	3.35	67.67%
		Growth(%) =	4.53	4.53		4.53	4.53	

Additionally, Dr. Roger Ibbotson refers to flotation cost in his book, Stocks, Bonds, Bills and Inflation, when he discusses the cost of capital. He states the following:

> Although the cost of capital estimation techniques set forth later in this book are applicable to rate setting, certain adjustments may be necessary. One such adjustment is for flotation costs (amounts that must be paid to underwriters by the issuer to attract and retain capital).[40]

The flotation costs associated with debt for large issues conservatively are approximately 1 to 3%. For relatively large issues of equity, the flotation costs range from a low of 2% to as much as 6%. The amount of flotation costs used in determination of the cost of capital are 1.00% for debt and 4.50% for equity. These figures are supported by information from

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[39] Roger A. Morin, PhD, *Regulatory Finance: Utilities' Cost of Capital*, (Arlington, VA: Public Utilities Reports, Inc., 1994), p. 170. (emphasis added)

[40] *Stocks, Bonds, Bills and Inflation: 1999 Yearbook, Valuation Edition* (Chicago: Ibbotson & Associates, Inc., 1999), p. 34.

the railroad industry and the February 2002 issue of *Public Utility Finance Tracker*.

The Sales Comparison Approach to Value

In the appraisal field it is well recognized that cash equivalent prices, which are the result of arms-length trading between reasonably informed buyers and sellers — under no coercion and under no unusual time limitations or pressures — are the best evidences of value. Indeed, such prices are value.

There is a very limited amount of actual sales data to be used as an evidence of value for the valuation of major going-concern business enterprises such as railroads and public utilities. Regarding this phenomenon Mr. William R. Field, an economic analyst with H. Zinder & Associates, Inc. states the following.

> Obviously, it is impossible to adjust prices which are available on residential and farm property and use such adjusted prices to properly determine market value for a huge business enterprise such as, for example, a pipeline. Indeed, even sales prices for other business enterprises, and even other pipelines, might not be good indications of value for a particular, and usually unique, pipeline. Equating differences among or between business enterprises, even within the same general business field, requires so many subjective adjustments that the sales comparison approach is just not available as a practical matter in the field of public utility valuation.[41]

Because of the lack of comparable sales price data in the railroad and public utility field, appraisers have had to search for proxies or substitutes for such indicators of value. To some appraisers, it appears logical that since there seldom are available objective market evidences of value for business properties, the next best alternative is the market price of

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[41] Field, William R., "Market Value of Stock and Debt as Evidence of Market Value," *National Tax Journal*, June, 1972, 243.

the securities of the enterprise owning the properties. It is assumed that the market value of the securities is the market value of the assets of the business enterprise. Thus the stock and debt approach emerges as a substitute for the traditional sales comparison approach.

It is noteworthy to recognize that during any given day, month, or year, many of the outstanding securities of a particular enterprise are seldom involved in transactions. In fact, some companies have securities which are never publicly traded. Even when a company has common stock actively traded by the public, the portion traded in any time period is a relatively small part of the total shares outstanding. Even when security price data are available, an important question is, does such security price data, especially based on relatively small unit transactions, represent the value of the enterprise? Many financial experts believe the motivation and expectations of the investors, each separately buying insignificant quantities of the outstanding stocks, are geared very much to their individual portfolio and marketability needs. They do not want to own and operate the enterprise; they want to own the stock and all the rights which are attached to such ownership.

One who advocates the stock and debt approach as the primary evidence of value for the underlying assets should consider that the stock ticker too often registers an aggregate valuation for enterprises that is totally unrelated to what a normal appraisal of the underlying business would produce.[42]

> It was little short of nonsense for the stock market to say in 1937 that General Electric Company was worth $1,870,000,000 and almost precisely a year later that it was worth only $784,000,000. Certainly nothing had happened. . . To speak of these prices as representing

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[42] Louis Lowenstein, *What's Wrong With Wall Street* (New York: Addison-Wesley Publishing Co., Inc., 1988), 43.

> "investment values" or the "appraisal of investors" is to do violence either to the English language or to common sense, or both.[43]

Another disquieting factor is that the stock market is largely a market of secondary transactions, a market of derived demands. It is very unlike the wheat market, for example, where the ultimate purchasers do not make their purchases with a view to resale but rather to feed livestock or make flour. No investor ordinarily buys stocks to consume either them or their underlying resources. The latter are, of course, legally inaccessible to the shareholders. Instead, stocks are bought for resale, except such few as are from time to time taken off the market in mergers, liquidations, and stock repurchase programs. From year to year, the great majority simply move from hand to hand, bought by shareholders whose expectations of a return of capital and most of the return on capital depend entirely on the willingness of others to share such expectations.[44]

The purchasers of stocks and purchasers of assets have different motivations, and thus, the stock and debt indicator loses much of its credibility as an indicator of the market value of a company's operating properties. Some of the fundamental investment differences between and investment in securities and real or personal property are pointed out by Pratt, Reilly, and Schweihs quoted as follows:

> *Fundamental Investment Difference between Investment Securities and Real Estate/Tangible Personal Property.* Table 29-2 summarizes some of the intrinsic differences between capital market securities (whether debt or equity instruments) and real estate and tangible personal

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[43] Benjamin Graham and David L. Dodd, *Security Analysis*, 2nd ed., (New York: McGraw-Hill, 1940), 10-11.

[44] Louis Lowenstein, *What's Wrong With Wall Street*, 44-45.

property (either individual assets or going concern assemblages of assets) as investment alternatives.

Table 29-2

Investment Differences between Securities and Real Estate/ Personal Property

Securities (Debt or Equity Instruments)	Real Estate/Personal Property (Individually or as a Mass Assemblege)
1. Liquid, marketable investments	1. Illiquid investments
2. Noncontrolling interest in income production and distribution	2. Controlling interest in income production and distribution
3. Small, absolute dollar investment required	3. Large, absolute dollar investment required
4. Small percentage of overall wealth committed to this investment	4. Large percentage of overall wealth committed to this investment
5. Diversified portfolio of investments	5. Nondiversified portfolio of investments
6. Short-term investment time horizon	6. Long-term investment time horizon
7. Does not require re-investment to maintain investment base	7. Requires "replenishment" investment to maintain investment base
8. Investments expected to appreciate over time	8. Investments expected to depreciate over time
9. Income typically subject to only individual tax (from investor's perspective)	9. Income typically subject to both corporate and individual tax (from investor's perspective)
10. Portfolios can be created in limitless combinations of risky securities and risk-free securities	10. Portfolio limited to the particular combination of real estate and personal property that operate the subject business

> As the table indicates, there are fundamental investment risk and return differences between (1) marketable, minority interests in debt and equity securities and (2) nonmarketable, controlling interests in operating real estate and tangible personal property. Due to these differences, and for other reasons, it is unlikely that an economic model that correlates nondiversified risk and expected return for one type of investment will effectively serve the same function for such a different type of investment.[45]

When using the stock and debt approach the liabilities and equity can be summed and the appraiser can deduct the non-operating property to arrive at the indication of market value for the subject property by the stock and debt approach. The computations for the stock and debt approach, including the non-operating property deduction, begin on the following page. These computations are followed by a graphic representation of the stock prices for CSX Corporation for the year 2001 and by the explanation of the stock and debt approach.

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[45] Pratt, Reilly, & Schweihs, *Valuing A Business*, 3rd edition, (Chicago: Irwin Professional Publishing, 1996), 708.

CSX TRANSPORTATION, INC.
Stock and Debt Approach - Stock Allocation Procedure
January 1, 2002

Obligation	Interest Rate	Actually Outstanding	Market Price	Market Value
Equipment Trust Certificates				
CSXT-223	Various	$19,000,000	$106.900	$20,311,000
CSXT-224	Various	20,250,000	103.700	20,999,250
CSXT-225	Various	10,000,000	104.700	10,470,000
CSXT-226	Various	29,400,000	101.600	29,870,400
CSXT-227	Various	18,200,000	109.700	19,965,400
CSXT-228	Various	31,200,000	107.100	33,415,200
CSXT-230	Various	30,400,000	103.000	31,312,000
CSXT-231	Various	34,200,000	103.400	35,362,800
CSXT-232	6.140%	41,203,233	108.500	44,705,507
CSXT-233	Various	42,809,106	100.000	42,809,106
CSXT-234	Various	36,000,000	103.100	37,116,000
CSXT-235	Various	55,000,000	101.200	55,660,000
CSXT-236	Various	60,000,000	97.400	58,440,000
CSXT-237	Various	48,000,000	99.700	47,856,000
CSXT-238	Various	44,400,000	104.600	46,394,000
CSXT-239	Various	66,300,000	107.500	71,272,500
CSXT-240	Various	54,600,000	101.900	55,637,400
Bridged Jets	Libor+	32,054,618	102.400	32,823,824
Total Equipment Trust Certificates		$873,016,857		$894,424,389
Conditional Sales Agreements				
CSXT 422	6.644%	$51,181,000	$101.100	$51,743,991
CSXT 423	6.300%	62,522,236	99.400	62,147,104
CSXT 424	Floating	71,897,000	100.000	71,897,000
CSXT 425	10.250%	1,791,881	100.000	1,791,881
Total Cond. Sales Agreements		$187,392,119		$187,579,976
Capitalized Leases				
CSXT 633	6.180%	$10,013,504	$108.800	$10,894,422
CSXT 634	6.180%	10,713,147	106.800	11,441,841
CSXT 636	7.760%	20,449,827	102.100	20,879,273
CSXT 637	6.830%	12,031,556	102.300	12,308,282
CSXT 638	6.830%	11,599,295	102.300	11,866,080
CSXT 640	8.920%	12,070,790	101.500	12,251,851
CSXT 644	9.570%	6,287,441	107.000	6,727,562
CSXT 646	9.570%	4,545,139	110.000	4,999,653
CSXT 647	9.570%	2,067,228	110.000	2,273,950
CSXT 648	9.570%	3,347,097	107.000	3,581,394
CSXT 656	9.570%	3,877,435	107.000	4,148,856
CSXT 658	9.570%	1,745,082	107.000	1,867,216
CSXT 660	9.570%	1,571,704	107.000	1,681,723
CSXT 662	9.790%	404,811	107.000	433,148
Total Capitalized Leases		$100,724,037		$105,155,050
Mortgage Bonds & Other				
8 LAN 1st Ref Ser 'F'	3.375%	$28,730,000	$95.059	$27,310,451
9 LAN 1st Ref Ser 'G'	2.875%	26,131,000	93.980	24,557,914

CSX TRANSPORTATION, INC.
Stock and Debt Approach - Stock Allocation Procedure (cont.)
January 1, 2002

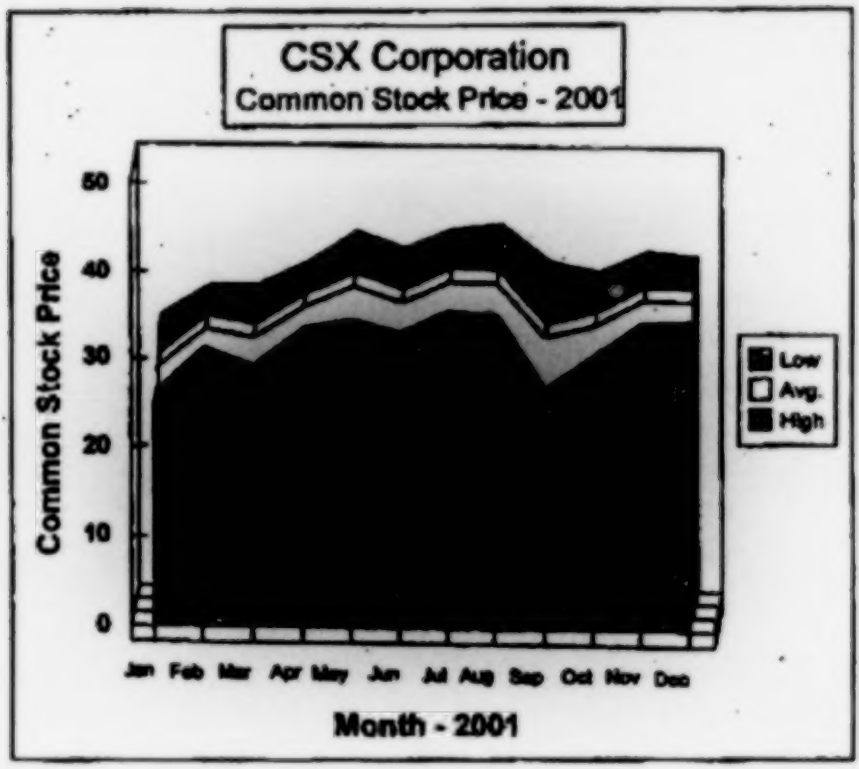
Obligation	Interest Rate	Actually Outstanding	Market Price	Market Value
828 SCL Marion RR Co 6%	6.000%	3,170,000	98.000	3,106,600
536 C&O PPA Rev Bnds 1992	6.000%	17,100,000	102.000	17,442,000
931 for Toledo-Lucas Cty PARB	6.450%	29,700,000	94.000	27,918,000
Total Mortgage Bonds & Other		$104,831,000		$100,334,965
Accounts Payable: Affiliated Companies		$7,188,000	$100.000	$7,188,000
Conrail Long-Term Debt (42%)		485,520,000	100.000	485,520,000
Totals (Long-Term Debt)		$1,588,672,013		$1,580,202,380
Current & Accrued Liabilities		$3,107,577,000	$100.000	$3,107,577,000
Conrail Current & Accrued Liabilities (42%)		167,580,000	100.000	167,580,000
TOTALS (ALL DEBT)		$4,633,829,013		$4,855,359,380
CAPITAL STOCK - COMMON				
CSX Shares Outstanding	Price	CSX Stock Value	CSXT	
213,887,988	$34.59	$7,392,180,075	78.86%	$5,836,866,755
Gross Value of CSXT Stock and Debt				$10,692,068,135
Less: Non-Operating Property			9.87%	1,068,305,941
INDICATION OF VALUE BY STOCK & DEBT APPROACH				$9,636,750,194
			(Rounded)	$9,637,000,000

Computation of Non-operating Property Deduction

Operating Net Plant + Material & Supplies	$16,990,835,227
Total Assets (Operating & Non-Operating)	17,742,738,227
Percent Operating Assets to Total Assets	90.13%
Total Asset Percent	100.00%
Less Operating Asset Percent	90.13%
Non-Operating Asset Percent	9.87%

CSX Corporation
Common Stock Prices During 2001

Month - 2001	High	Low	Average
Jan	$30.54	$24.81	$27.68
Feb	33.99	29.75	31.87
Mar	34.11	27.70	30.91
Apr	36.90	32.05	34.48
May	40.20	33.25	36.73
Jun	38.47	31.60	35.04
Jul	40.72	34.10	37.41
Aug	41.30	33.75	37.53
Sep	36.92	25.44	31.18
Oct	35.98	29.37	32.68
Nov	38.20	32.90	35.55
Dec	37.66	33.45	35.56
Averages	$37.08	$30.68	$33.88
Average Price of CSX Stock For Last 3 Months			$34.59



Explanation of the Stock and Debt Approach

Sales of strictly operating railroad systems such as CSX Transportation Inc. rarely occur. There is a great deal of difficulty in adjusting for dissimilarities in large railroad systems such as operating area, economics of the area served, physical factors, and financial differences. These differences make a comparison virtually impossible even for arms-length sales. For these reasons a sales comparison approach cannot be used in the appraisal of the operating property of CSX Transportation Inc. Partial sales or sales of dissimilar systems will not be indicative of the market value of the operating property of CSX Transportation Inc. We used the stock and debt approach as a substitute for the normal sales comparison approach.

The stock and debt approach (stock allocation procedure) method is based on the accounting principle that assets equal liabilities and equity. In theory, the value of all of the assets on the balance sheet will be the equal to the value of the liabilities on the balance sheet. Because the gross stock and debt value includes all of the liabilities and equity of the business enterprise, it will also include all of the operating and non-operating properties, both tangible and intangible properties. Thus, the non-operating properties must be deducted in order to obtain the market value of the operating assets.

We obtained the market value of the long-term debt of CSX Transportation Inc. from Company officials and checked the reasonableness of these figures with information found in *Mergent Bond Record.* We added the book value of the current liabilities to the market value of long-term debt to obtain a value of all the debt of $4,855,359,380.

For the value of common stock of CSX Transportation Inc. we multiplied the number of shares of common stock of CSX Corporation outstanding at the appraisal date times the aver-

age price of the stock during the last quarter of 2001 to obtain a market value of $7,392,180,075 (213,687,996 shares times $34.59 = $7,392,180,075). This figure was then adjusted by 78.96% to reflect the contribution of the subject company, CSXT, to the parent company, CSX Corp. The calculation is based upon the contribution of CSXT to the total operating income of CSX Corp (or $803,000,000 as a percentage of $1,017,000,000 = 78.96%). Upon summing all of the stock and debt the indicated gross total market value was $10,692,056,135. From this amount we deducted the non-operating property.

To estimate the influence of non-operating properties on the gross stock and debt value, we used the asset ratio method. The asset ratio method compares the operating assets to the total assets to arrive at the operating railroad property percentage of 90.13%. This figure was subtracted from 100.00% to arrive at the non-operating percentage of 9.87%. The non-operating percentage of 9.87% was applied to the gross stock and debt value to arrive at the amount of non-operating property, $1,055,305,941. After deducting the non-operating property from the gross stock and debt value, the indication of value for the operating railroad property of CSX Transportation Inc. by the stock and debt approach as of January 1, 2002, was $9,636,750,194 rounded to $9,637,000,000.

The stock and debt indicator for the appraisal of the operating property of CSX Transportation Inc. should be given much less weight than either the income approach or the cost approach in the final consideration of value. It is certainly clear that one's motives for investing in the stock of a particular enterprise are quite different from the motives of one who purchases the company's operating assets. A purchaser of stock is typically making a relatively short-term investment in a highly liquid instrument of trade. On the other hand, a purchaser of operating assets typically has in mind a

longer term commitment to the use of those assets in order to produce a return thereon.

With differences in motivation by the purchasers of stocks and purchasers of assets, the stock and debt indicator loses much of its credibility as an indicator of the market value of a company's assets. We believe the stock and debt indicator for the operating property of CSX Transportation Inc. serves no useful purpose in the indication of market value. For the indicator of value by the stock and debt approach to have any significant validity, it should be adjusted further for the impact of minority interests being traded and the illiquidity of the assets being appraised versus the prices of stocks being traded. Some studies have suggested that the effect of these two adjustments would be a reduction of the stock prices by approximately 37.5%.[46] Thus, we believe that the stock and debt indicator unadjusted for minority interest and illiquidity discounts must be given very little weight in the overall estimate of value.

Although we considered the sales comparison approach and its surrogate the stock and debt approach, we believe for the reasons stated above that neither a sales comparison approach nor the stock and debt approach is useful in the valuation of the operating assets of CSX Transportation Inc. as of January 1, 2002.

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[46] See Robert F. Reilly, "*Illiquidity Discounts — To Be or Not To Be?,*" paper presented at the Appraisal for Ad Valorem Taxation of Communications, Energy and Transportation Properties Workshop, Wichita State University, August 1997, in which he states that a discount of 37.5% was applied to the capital market values in order to properly estimate the value of the unit of operating property of railroads.

Reconciliation and Value Conclusions

The process of resolving the differences among various value indications is called reconciliation. Reconciliation has been defined by the Appraisal Institute as "*the analysis of alternative conclusions to arrive at a final value estimate.*"[47] It is the bringing of the elements into balance with one another to constitute a unified and coherent whole.

Reconciliation is not just a simple weighing of three approaches; it's the weighing of information used in the various approaches. The process of correlation is continuous from the beginning to the end of the entire appraisal. It is a guiding principle in each major step of the appraisal. All throughout the appraisal process, the appraiser is making decisions, judgments, and evaluating the relevance, importance, and reliability of the data used in each approach.

The indications of value developed by the three approaches to value are as follows:

Value Indicator	Amount
Cost Approach	$6,150,000,000
Income Approach	$5,983,000,000
Stock & Debt Approach	$9,637,000,000

The cost approach was analyzed in detail and given careful consideration. The original cost less depreciation is considered the best starting point in the cost approach. With the deduction of all forms of depreciation, the cost approach can be used to estimate the value of a railroad company, however, as mentioned on page 22, the cost approach offers little insight when valuing the total assets of the business. The cost

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[47] *The Appraisal of Real Estate*, 10th ed., (Chicago: Appraisal Institute, 1992), 553.

approach was given minor consideration in the final opinion of value.

The income approach was also given careful consideration. The potential income stream of CSXT has been analyzed. It was necessary to consider Company projections and other historical and economic data in predicting future income. These estimates were correlated with our own estimates, based on our analysis of the expected earnings. The money market has been analyzed and much study given to the estimation of a reasonable rate of capitalization. A prospective purchaser of railroad property would very carefully consider the earning capability of the property. The income approach is a strong indication of value, and it was given major weight and emphasis in the final opinion of value.

The sales comparison approach could not be used in the ordinary manner as there are no actual arms-length sales of truly comparable properties. The stock and debt approach was considered as a substitute, however there are many problems associated with using traded prices for stocks and securities as surrogates for the value of the underlying assets. The stock and debt as an indicator of value, particularly when the subject company has no traded stock, is rarely useful. Thus for this appraisal we do not believe the stock and debt approach provides any meaningful insight into the market value of the operating assets of CSX Transportation Inc. as of January 1, 2002. For this appraisal report, the stock and debt approach was considered but given no weight in the final opinion of market value.

The basis of this appraisal is the unit method of appraisal. The unit method of estimating the market value for this property is in accordance with generally accepted practice for the appraisal and valuation of properties. It is our belief that a buyer and seller would go through these same processes in an effort to reach a sale price for the operating assets of CSX Transportation Inc. The property is presently serving in the

capacity for which it was constructed. The value conclusion reflects the willing buyer, willing seller concept in an arms-length transaction.

It is not always possible to use three approaches to value in every appraisal. Regarding the reconciliation of the value indicators Dr. Boykin and Dr. Ring state:

> Applying judgment, however, assumes *knowledge* of that to be judged. Thus a reconciliation of the value indicators is not a mathematical or statistical exercise but rather a matter of considered judgment wherein the professional experience and educational training of the appraiser is called upon to determine the final conclusion of value. There might be occasions where only one approach to value is guiding, but generally two or all three approaches contribute in the formulation of the appraiser's judgment. Logic dictates that as a rule the income approach offers the best guide to value since, in the final analysis, value is the "present worth of future rights to income.". . . Since income, however, is the motivating factor for business activities, reason warrants that as a rule the income indicator of value be given the greatest weight, cost lesser weight, and stock and debt the least weight in the final estimate of value.[48]

Thus, reconciliation is not a mathematical exercise but rather a serious judgmental exercise by the professional appraiser to reach a logical conclusion of value.

Final Conclusion of Value

After careful consideration of all pertinent data, and after considering the indications of value, giving the most weight and emphasis to the income approach, less weight to the cost approach, and no weight to the stock and debt approach, it is my opinion that the market value of the system operating

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[48] Alfred A. Ring and James H. Boykin, *The Valuation of Real Estate*, 3rd ed. (Englewood Cliffs, NJ: Prentice-Hall, 1986), 427.

property of CSX Transportation Inc. as of January 1, 2002, was:

SIX BILLION DOLLARS
($6,000,000,000)

Certification

I certify that, to the best of I [sic] knowledge and belief, . . .

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and we have no personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my engagement in this assignment was not contingent upon developing or reporting predetermined results.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the Code of Professional Ethics and the Standards of Professional Practice of the Appraisal Institute and the International Association of Assessing Officers.
- the use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.
- as of the date of this report, Thomas K. Tegarden has completed the requirements under the continuing education programs of the Appraisal Institute and the International Association of Assessing Officers.
- this appraisal is based on an analysis of financial information and I have not made a personal inspection of the physical property that is the subject of this report.

- no one provided significant professional assistance to the undersigned other than Diane M. Ange, SRA, CAE, who helped gather and record historical financial data.

/s/: Thomas K. Tegarden
THOMAS K. TEGARDEN, MAI, CAE

Assumptions and Limiting Conditions

1. The appraiser did not make a survey of the property. The appraisal of this property is based on an economic approach and none of the property was physically inspected during the course of this appraisal.
2. The appraiser believes that the facts, statements, and opinions contained in this report are reliable and supportable. No responsibility is assumed for the accuracy of information obtained from CSX Transportation Inc., other informed sources, or from other published material which was available.
3. The appraiser assumed that this property is under responsible ownership, is a railroad company, and is under competent management consistent with the regulations.
4. The various approaches to value used in this report may not be considered separately or independently of each other, and the final value conclusion is predicated on a careful reconciliation of all value indicators.
5. The value conclusion in this report represents the appraiser's opinion of the market value of the operating property of CSX Transportation Inc. as of January 1, 2002. The unit method of appraisal has been used in conformance with the recognized appraisal practices for property of this type.
6. The appraiser reserves all rights to the contents and reproductions of this appraisal report, especially conclusions and computations relating to the subject property. No part of this report shall be disseminated to the public through the advertising media, public relations media, news media, or any other public means of communication without the prior written consent of the appraiser.
7. The appraiser may not be required to give testimony or to appear in court by reason to this appraisal, with reference to the property in question, unless prior arrangements have been made therefor.

Professional Qualifications of

Thomas K. Tegarden, MAI, CAE

Tegarden & Associates, Inc., 105 Point East Dr.,
Nashville, TN 37216-1403
(615) 226-2300 Office,
(615)226-4488 FAX

Degrees and Professional Appraisal Designations

B.S. Accounting, Middle Tennessee State University, 1967

MAI (Member, Appraisal Institute) - Appraisal Institute - certified through December 31, 2003 - Member No. 6275

CAE (Certified Assessment Evaluator) - International Association of Assessing Officers - certified through December 31, 2006 - Member No. 516

Tennessee Certified General Appraiser, Tennessee License No. CG-93

Appraisal Education

I have taken numerous appraisal and appraisal related courses conducted by the Appraisal Institute (AI), the International Association of Assessing Officers (IAAO), and other organizations toward the goal of earning the MAI and CAE professional appraisal designations. I received the CAE in 1974 and the MAI in 1981. I have taken several additional appraisal courses through the Appraisal Institute, IAAO, and other organizations in order to maintain a "currently certified" status as an MAI and a CAE to continue to further my appraisal education. I am presently certified as an MAI through December 31, 2003 and as a CAE through December 31, 2006. As of the date of this report I have completed all the requirements under the continuing education program of the AI, the IAAO, and the appraisal license program of the State of Tennessee.

Professional Activities & Memberships

Appraisal Institute

MAI - Member, Appraisal Institute - Certificate #6275
Member of Local Chapter #37
Member of Professional Admissions Committee - Tennessee Chapter #37 – 1982

International Association of Assessing Officers (IAAO)

Member IAAO since 1972
CAE - Certified Assessment Evaluator - Certificate #516
Senior Instructor - IAAO's Educational Program (1983 - present)
Demonstration Report Grader
Chairman - Residential Grading Committee & Chief Review
Grader 1981-90
Member IAAO Course 2 Re-write subcommittee - 1985-86-87
Primary Author IAAO Course 102 - 1993 (*Income Approach to Value*)
One of Three Authors of IAAO Course 101 - 1992-1993
Member IAAO Executive Board - 1982-83
Member Professional Admissions Committee 1980-81
Member Constitutional Review Committee 1979
Professional Designation Advisor - States of KY and TN 1981-85

Faculty Associate - Lincoln Institute of Land Policy Southern Association of State Property Tax Administrators

President -1976, Treasurer - 1975

Tennessee Chapter of IAAO

Published Works

"Future Expectations and Growth: Do They Affect Present Value?," *Journal of Property Tax Management*, Pub. 2:3, Panel Publishers, Inc., (1st Qtr., 1991)

"Inflation and Utility Property Appraisal," *Public Utilities Fortnightly*, Vol. 123, No. 11 (May 25, 1989)

"Controversy in the Valuation of Utility Property: A Rejoinder," *Public Utilities Fortnightly*, Vol. 123, No. 5 (March 2, 1989)

"Appraising Public Utilities: Direct Capitalization and Present Value," *The Appraisal Journal*, January, 1989, The American Institute of Real Estate Appraisers

"Direct Capitalization vs. Yield Capitalization: In the Appraisal of Public Utility Property," *Assessment Digest*, September/October, 1987, International Association of Assessing Officers

"Creative Financing: The Assessor's Viewpoint," *Property Tax Journal*, September, 1983, International Association of Assessing Officers

Awards

1989 recipient of the *Verne W. Pottorff Professional Designee of the Year Award* from the International Association of Assessing Officers. This award is given annually to the IAAO professional designee who has most effectively promoted the interests and goals of the IAAO professional designation program.

1984 recipient of the *Bernard L. Barnard Award* from the International Association of Assessing Officers. This award is given annually to the author of the article published in the *Property Tax Journal* which has contributed the most to the improvement of assessment administration.

Experience

Owner - Tegarden & Associates, Inc. - duties include client consultation, appraisal of public utilities, railroads, special purpose properties, and expert testimony

Was employed by the Tennessee Public Service Commission 15 years — 1967 - 1983 where I was Assistant Director of Assessments for 11 years. My duties included the annual appraisal and assessment of

approximately $4 billion ($4,000,000,000) of railroad and public utility property

Instructor - Seminar on Public Utility Valuation - Wichita State University - sponsored by National Tax Association - Tax Institute of America and Wichita State University

1985 - 2003 "Principles of Appraisal for Public Utility and Railroad Property"

2003 "Advanced Income Approach Issues"

1997 "Advanced Cap Rate Applications"

1993 "DCR Method" and "Weighted After-Tax Cost of Capital and Cap Rate"

1992 "Selection of Income & Rates in Yield Capitalization"

1990 "Future Expectations and Growth: Do They Affect Present Value?"

1986 "Direct Capitalization vs. Yield Capitalization"

1980 "Administrative Problems with Deferred Federal Income Taxes and the Investment Tax Credit"

1978 "Demonstration Appraisal of Telephone Company"

1976 "Special Problems Including Correlation"

Consultant to Georgia Department of Revenue - 1980, 1984,1985, 1998, 1999, & 2000; Missouri State Tax Commission - 1980; Tennessee Attorney Generals Office -1983; Citrus County, FL - 1983; St. Lucie County, FL - 1984; Oklahoma Tax Commission - 1983; Hendry County, FL - 1984; Putnam County, FL - 1990; Dallas County, TX Appraisal District - 1983, 1997; Michigan State Tax Commission - 1985; Florida Department of Revenue - 1985 - 1986; Colorado Legislative Council - 1988-89, Wyoming Tax Commission and State Board of Equalization - 1989 - 1990; Colorado Department of Property Taxation - 1989, 1991, 1993; City of Valdez, Alaska - 1990, 1992; South Dakota Department of Revenue - 1991, 1992; North Slope Borough, Alaska - 1994, 1997; Sarasota County, FL - 1995-96.

Faculty - Land Reform Training Institute (Instructor of appraisal course to students from 12 countries) Taoyuan, Taiwan, Republic of China

Faculty - Lincoln Institute of Land Policy

"The Economic Foundations of Railroad and Utility Valuation," Scottsdale, 1995

"Understanding the Capitalization Process," Scottsdale, AZ, 1994

"The WHYs and HOWs of Railroad and tility Valuation," Scottsdale, AZ, 1991

Senior Instructor - Course 102 - The Income Approach to Valuation (International Association of Assessing Officers) - West Palm Beach, FL; Auburn University; Sarasota, FL; Troy, NY; Jacksonville, FL; Tampa, FL; Columbia, MO; Orlando, FL; Miami, FL; University of Virginia; Denver, CO, Austin, TX, Mississippi State University — 1983 - 2003

Senior Instructor - Contemporary Real Estate Finance (International Association of Assessing Officers) - Montana State University - Bozeman, MT – 1984

Senior Instructor - Introduction to Income Approach to Value Workshop - (International Association of Assessing Officers) Oklahoma City, OK - 1987, Lubbock, TX - 1988

Author and Instructor of copyrighted *Public Utility Basic Appraisal Course*© -LaBelle, FL - 1984; Tallahassee - 1986; Cheyenne - 1989, 1990, 1991, 1992, 1993, 1995, 1996, 1997, 1998, 1999, 2001, 2002, 2003; Austin - 1989; Atlanta - 1992; Denver - 1994; Pierre, SD - 1999

Author and Instructor - *The Development and Use of the Compound Interest Tables* and *Using the HP-12C Calculator* (for Colorado Department of Revenue, 1991 & for International Association of Assessing Officers, 2002)

Program Speaker and Participant - Valuation Roundtable - Phoenix, AZ (Lincoln Institute of Land Policy) - 1984

Program Speaker and Participant - IAAO Public Utility Seminar - New Orleans -2002, Nashville - 1997, New Orleans - 1995

Program Speaker - Annual Professional Seminar - Jointly Sponsored by American Institute of Real Estate Appraisers, International Association of Assessing Officers, and Society of Real Estate Appraisers

17th Seminar - "Creative Financing: The Assessor's View-point" - Kansas City, MO -1982

30th Seminar - "Valuation Issues in the Telecommunications Industry: The Capitalization Rate" - Chicago, IL - 1995

Instructor - CASPER (Computer Assisted Analysis of Special Purpose Properties for Education and Research) - Lincoln Institute of Land Policy - Cambridge, MA - 1982, 1983 - San Francisco, CA -1983, Orlando, FL - 1984

Instructor - Microcomputer Techniques for Special Property Appraisal (Course 109) - Lincoln Institute of Land Policy - Orlando, FL - 1984

Instructor - Institute of Property Taxation - Kellogg School of Business - Michigan State University 1987 "The Appraisal of Railroads and Public Utilities," 1983 "Appraisal of Mineral Interests" and "The Appraisal of Railroads and Public Utilities"

Program Speaker - National Association of Railroad and Public Utility Tax Representatives - Atlanta, GA - 1983; Denver, Colorado - 1986

Instructor - North Carolina IAAO Candidates Club - University of North Carolina - Chapel Hill, NC - 1984

Instructor - International Association of Assessing Officers - Personal Property Seminar - Scottsdale, AZ and Virginia Beach, VA - 1985

Program Speaker - IAAO Conference

Houston, TX - 1996, "Regulation: Its Impact on Value"

Washington, D.C. - 1993, "The Appraisal of Public Utilities & Commercial Properties: What's the Difference?"

Montreal, Quebec - 1990, "The Role of the Consultant in the Ad Valorem Tax Process"

Nashville; TN - 1988, "The Valuation of Public Utilities & the Potential for Growth"

Louisville, KY - 1981, Detroit, MI - 1980, and Atlanta GA - 1976

Expert Testimony

Numerous times - state and federal courts, state assessment boards, public service commissions, and legislative committees as an expert appraisal witness regarding the valuation of public utilities, railroads, special purpose properties, commercial, industrial, and residential properties.

RAILROAD VALUATION WORKSHEET

Tax Year: 2022 Company: CSX Transportation Company No: 176

Summary and Correlation of Unit Value Indicators

Stock & Debt Approach			13,003,785,359
Discounted Cash Flow Analysis			8,139,760,350
Comparable Publicly Traded Company Analysis	Metric Level	Multiple	
	Revenue	2.00	12,348,480,000
	EBITDA	7.60	10,788,011,560
	EBIT	9.50	8,474,791,500
Other			
Book Value (Owned and Leased)			15,809,450,337
UNIT VALUE ESTIMATE			9,290,900,000

Correlation: The discounted cash flow analysis is the preferred methodology for valuing a business and, when adequate data exists, should be given the most consideration.

Analysis of Unit Value Estimate

Percentage of Gross Investment	37.54%
Percentage of Book Value	51.67%
Percentage of Parent Company Gross Stock & Debt	53.66%

Allocation to Georgia

EXEMPT PORTION OF UNIT VALUE	458,000,000	Pollution Control	400,000,000
TAXABLE UNIT VALUE ESTIMATE	7,830,900,000		
System Road Miles	33,397		
Georgia Road Miles	1,679		
Percentage	7.1940239%		
Indicated Georgia Gross Operating Property Value	563,136,693		

Calculation of Georgia Net Taxable Values

	Indicated	Adjusted	Indicated Factor	DOR Factor	DOR Value
Indicated Georgia Gross Operating Property Value	563,136,693	374,080,205			
Deductions: Motor Vehicles	4,156,193	4,156,193			
Pollution Control	3,907,487	7,744,781			
Exempt Line	38,210,371	28,170,053			
Total Taxable FMV of operating property in GA	514,862,671	337,023,203	1.52758176	1.52758176	514,862,672
Total Taxable FMV of non-operating property in GA	27,907,489	27,758,511			27,907,489

Deduction Calculations

Pollution Control			PMLA		
Gross Investment	7,744,781		% of Georgia Total	18.91285%	
FMV %	37.54%		PMLA FMV	84,342,316	
FMV	3,907,487		Op. Real Estate	5,773,379	
			Track & Rolling Stock	75,518,941	
			Track (50%)	38,259,471	
			Side Track	49,000	
			Exempt Main Line	38,210,371	

Historical Information

End of Year TAX Data

Operating Company				Parent Company		
Income Statement				Balance Sheet		
Mat. & Supplies	181,369,000			Mat. & Supplies	306,000,000	
Income Statement				Current Assets	2,574,000,000	
Misc. Rent Income	13,600,000			Total Assets	29,871,000,000	
Income from Lease of R&E	4,765,000			LTD (Incl. Maturities)	1,944,000,000	
Rent for Leased R&E	123,588,000			Current Liabilities	3,365,000,000	
Leased R&E Depr. (net)	79,948,000			Long Term Debt	8,839,000,000	
R-1 Sch 352a				Income Statement		
Investment in Prop	19,234,000,000			Revenues	8,119,000,000	
Oper. & Accum.	5,537,000,000			Expenses	7,883,000,000	
Leased Equipment Sch.				Other Income	9,000,000	
Original Cost	3,609,040,571			Cash Flow Statement		
Depreciated Cost	1,702,041,227			Depreciation	923,000,000	

	1996	1997	1998	1999	2000	2001
Historic Income Data						
Operating Revenue	-	-	4,956,000,000	5,423,000,000	6,075,000,000	6,383,000,000
Operating Expense	-	-	3,953,000,000	4,294,000,000	5,468,000,000	5,394,000,000
Depreciation & Amortization	-	-	450,000,000	488,000,000	630,000,000	550,000,000
Operating Ratio	0.00%	0.00%	79.80%	83.33%	90.00%	87.59%
Capital Expenditures	-	-	1,213,000,000	1,298,000,000	923,000,000	848,000,000
Historic Rate of Change						
Operating Revenue				13.48%	8.64%	8.13%
Operating Expense				21.31%	15.80%	-3.69%
Depreciation & Amortization				8.00%	7.00%	9.77%
Operating Ratio				6.92%	5.43%	3.20%
Capital Expenditures				7.10%	-36.67%	3.16%

PLAINTIFF'S EXHIBIT 32

Discounted Cash Flow Analysis

The discounted cash flow analysis most clearly replicates the actions of the market in valuing a company or investment. It is founded on the principle that the value of any investment is equal to the present worth of all future cash benefits to be derived from ownership of the investment. The model used calculates the future operating free cash flows for ten years and a reversion value at the end of that period based on a limited number of assumptions relative to revenue, expense, and capital expenditure patterns. When insufficient data exists upon which to base these assumptions, the model is extremely useful for testing the reasonableness of the result of other approaches to value.

Predicted Variables for Discounted Cash Flow Analysis

Operating Revenue Rate of Change	1.50%
DA Rate of Change	3.00%
Capital Expenditure Rate of Change	4.00%
Target Operating Ratio	80.00%
Income Tax Rate	39.00%

Discounted Cash Flow Analysis

Year	2002	2003	2004	2005	2006	2007
Operating Revenue	8,173,230,000	8,265,628,450	8,348,815,877	8,435,313,115	8,522,041,312	8,650,321,932
Operating Expense	6,333,670,720	6,388,914,042	6,440,843,493	6,498,269,643	6,470,984,456	6,506,486,540
Net Rent for Road	118,791,000	118,791,000	118,791,000	118,791,000	118,791,000	118,791,000
Misc. Rent Income	13,560,000	13,560,000	13,560,000	13,560,000	13,560,000	13,560,000
EBITDA	1,836,430,280	1,911,679,408	1,987,343,332	1,771,324,518	1,931,056,857	1,952,985,135
Depr. & Amort.	586,000,000	663,495,000	600,000,834	619,229,848	627,833,741	654,778,783
Depr. On Leased Road	79,848,000	79,848,000	79,848,000	79,848,000	79,848,000	79,848,000
EBIT	692,082,280	848,336,408	1,006,495,342	1,072,446,672	1,133,809,916	1,198,378,372
IT (39%)	347,912,988	368,939,223	392,533,199	418,254,202	442,187,829	466,947,583
Net Income	644,170,191	579,807,245	615,962,183	654,192,470	691,501,988	728,790,807
Operating Ratio	88.40%	85.70%	85.00%	84.20%	83.50%	82.60%
Change in Working Cap	1,784,227	1,885,772	1,943,838	651,324	1,424,513	1,385,337
Capital Expenditures	681,920,000	917,196,800	953,884,672	992,040,059	1,031,731,661	1,072,996,927
Operating Free Cash Flow	306,933,964	323,187,673	339,381,722	360,979,921	379,904,555	382,011,709
% change		5.32%	5.07%	6.10%	4.37%	0.21%
Reversion						
Total Cash Flow	306,933,964	323,187,673	339,381,722	360,979,921	379,904,555	382,011,709

Year	2008	2009	2010	2011	Market Multiple	Proceeds
Operating Revenue	8,758,978,761	8,831,327,912	8,954,997,451	7,269,409,294	2.00	14,118,818,588
Operating Expense	6,541,813,921	6,579,880,820	6,611,958,992	5,848,737,458		
Net Rent for Road	118,791,000	118,791,000	118,791,000	118,791,000		
Misc. Rent Income	13,560,000	13,560,000	13,560,000	13,560,000		
EBITDA	2,017,083,364	2,165,441,537	2,195,137,133	2,282,205,909	7.00	15,982,440,363
Depr. & Amort.	674,430,836	696,723,648	717,825,251	739,154,909		
Depr. On Leased Road	79,848,000	79,848,000	79,848,000	79,848,000		
EBIT	1,268,786,740	1,329,469,902	1,394,863,881	1,464,204,980	9.50	13,909,948,170
IT (39%)	491,706,829	517,479,257	543,818,914	571,039,943		
Net Income	768,079,911	808,380,685	850,744,967	893,164,963		(Discounted value of all future cash flows growing at a rate of 8.7%)
Operating Ratio	82.10%	81.40%	80.70%	80.00%		
Change in Working Cap	1,939,717	1,259,582	1,172,860	1,103,478		
Capital Expenditures	1,115,912,148	1,160,548,554	1,206,968,418	1,255,247,153		
Operating Free Cash Flow	408,144,672	434,178,104	440,978,942	455,918,343		13,459,243,084
% change	6.82%	3.83%	2.75%	3.58%		
Reversion				13,459,243,084		
Total Cash Flow	408,144,672	434,178,104	440,978,942	13,915,080,027		

	WACC	min	point est.	max
		9.30%	9.80%	10.20%
Indicated Value		7,877,732,465	7,518,317,143	7,249,123,651
Indicated Lsd. Eq. Adj.		622,190,081	607,978,209	601,873,881
Indicated Adj. Value		8,499,922,824	8,126,293,348	7,847,196,592

Leased Property Expense Adjustments

The operating cost of the public utility or railroad being valued is to include all operating assets owned or used in the utility or railroad operation. Therefore, the value of the utility or railroad company should be based on the income it would produce if it owned all operating assets. While the revenues produced by leased assets are already included in the operating revenues, the expenses are not properly recognized for. If the leased assets were owned by the operating company, the company would not have the lease payments associated with those assets but would be allowed the appropriate depreciation expense.

Annual Rent	2002	2003	2004	2005	2006	2007
Per Schedule	245,508,230					
Deductions	46,654,000	79,033,501	1,340,569	(60,438,457)	83,749	180,838
Adjustment	248,881,230	168,817,883	168,427,302	117,867,845	117,884,096	117,725,354

		2008	2009	2010	2011
	Deductions	2,915,748	5,910,410	3,119,290	-
	Adjustment	114,809,780	108,899,350	103,783,060	103,783,060

Annual Depreciation	2002	2003	2004	2005	2006	2007
Per Schedule	139,144,757					
Deductions	34,378,143	34,743,654	393,831	37,173,161	18,834	168,139
Adjustment	93,766,615	88,024,991	88,831,330	31,469,169	31,442,535	31,276,469

		2008	2009	2010	2011
	Deductions	1,088,393	2,451,365	2,487,736	-
	Adjustment	30,217,617	27,765,452	25,277,672	25,277,672

Leased Equipment Adjst	0	0	0	0	0	0
EBITDA	248,881,230	168,817,883	168,427,302	117,867,845	117,884,096	117,725,354
DA	93,766,615	88,024,991	88,831,330	31,469,169	31,442,535	31,276,469
EBT	155,087,615	100,792,892	99,795,972	86,398,676	86,451,561	86,448,885
IT (39%)	60,483,330	39,309,147	38,920,429	33,748,184	33,716,109	33,715,164
op inf	188,369,010	129,508,816	129,506,873	84,119,661	84,177,987	84,010,190

		2008	2009	2010	2011
	EBITDA	114,809,750	108,899,350	103,783,060	103,783,060
	DA	30,217,617	27,765,452	25,277,672	25,277,672
	EBT	84,592,743	81,133,898	78,505,388	78,505,388
	IT (39%)	32,991,170	31,642,332	30,617,101	30,617,101
	op inf	81,818,580	77,257,118	73,165,959	73,165,959

Stock & Debt Approach

The value of a company whose equity and debt securities are traded in the marketplace is determined by the sum of the values of those securities plus the net of its current liabilities less current assets. Unfortunately, the public utility and railroad companies being valued by the Department of Revenue are rarely publicly traded, but are often subsidiaries of such companies. Even when they are traded, not all of their assets are operating. At best, an educated guess of the portion of the total traded company's value attributable to the operating assets can be made. The more pure the traded company is, the more reliable the estimate can be deemed. This method is not applicable to valuing the operating assets of a public utility or railroad that is neither publicly traded nor has a publicly traded parent company.

TRADED PARENT COMPANY : CSX Corporation

January 1, 2002

			# of Shares	Price/Share	Market Value
		Stock	213,647,996	35.09	7,598,745,136
		LTD		Book Value	
				6,960,000,000	7,200,000,000
		Current Liabilities - Current Assets			381,000,000
		Gross Stock & Debt Value			15,219,745,136
		Operating Allocation			
	Revenues	EBITDA	EBIT	Assets	
Operating	8,982,004,000	1,349,540,000	709,680,000	14,286,794,000	
Total Company	8,115,000,000	1,648,000,000	1,026,000,000	18,933,000,000	
Percentage	74.07%	81.88%	77.83%	75.47%	75.09%
		Indicated System Operating Property Value			11,414,809,000
		Plus Leased Equipment			867,979,399
		Adjusted Indicated System Operating Property Value			12,282,784,399
		Notes:			
		Current Assets(-Asset)		1,884,000,000	
		Current Liabilities(-Curr.Liab)		2,265,000,000	

Comparable Publicly Traded Company Analysis

Income Level	Multiple	$	Financial Ratios	
Revenues	2.50	13,345,458,999	Payout Ratio	88.29%
EBITDA	7.00	10,793,911,943	Sales to Total Assets	38.85%
EBIT	9.50	9,474,791,944	Current Ratio	62.79%
			Operating Margin	24.82%

RAILROAD COST OF CAPITAL AND MARKET MULTIPLE STUDY

COST OF CAPITAL

The cost of capital is estimated by a band of investment method that combines estimated costs of equity and debt utilizing a market capital structure typical for the industry. An after tax cost of debt is utilized; therefore the estimated WACC (weighted average cost of capital) should be used to discount unleveraged after tax free cash flows.

COST OF EQUITY

The cost of equity is estimated based on a discounted cash flow model (DCF) and the capital asset pricing model (CAPM). The DCF derives the discount rate that equates the present value of future benefits (dividends and reversion) with the current price. In this application, d1 is the ValueLine estimate, P is a normalized year-end price based on an average of the fourth quarter monthly highs and lows, a trended year's monthly highs and lows, and the year end price, and g1 and g2 are short (3 year) and long term (years 4 through 10) growth rates based on ValueLine's projected earnings and assumption of the growth rate for the Gross National Product respectively. The reversion is based on the assumption that the price will change at the same rate as the dividend. The (CAPM) is based on the formula Ra = Rf + B x Rp where Rf is the risk free rate, B is the beta for the company's stock, and Rp is the risk premium. In this application, Rf and Rp are the long term variables published by Ibbotson Associates and the beta is the number published by ValueLine.

STOCK DATA — 2001 — 2002 — 2002 — 2005

COMPANY	CHOSEN YR END PRICE (P)	ESTIMATED DIVIDEND (d_1)	ESTIMATED EARNINGS	ESTIMATED EARNINGS	ESTIMATED 3 YEAR EARNINGS GROWTH (g1)	BETA
BURLINGTON NORTHERN SANTA FE RR	27.48	0.48	2.25	3.20	12.6%	0.95
CANADIAN NATIONAL RAILWAY	48.67	0.60	3.40	4.30	8.1%	0.86
CANADIAN PACIFIC RAILWAY LTD	18.67	0.33	1.80	2.25	12.0%	
CSX CORP	35.28	0.40	2.30	3.80	16.1%	1.10
NORFOLK SOUTHERN CORP	18.32	0.24	1.05	1.65	16.3%	1.05
UNION PACIFIC CORP	54.15	0.80	4.20	6.85	11.7%	0.90
Real GDP + GDP Price Index (VL) (gZ)	6.3%					
Long-Term Riskless Rate (20 year)	5.8%					
Equity Risk Premia (long-horizon)	7.4%					

INDICATORS

COMPANY	UNLEVERED BETA	DCF	CAPM	CAPM TYP CAP STRUCT	SIZE CAP	EQUITY %
BURLINGTON NORTHERN SANTA FE RR	0.89	9.4%	12.63%	12.98%	LARGE	61.4%
CANADIAN NATIONAL RAILWAY	0.77	7.8%	12.63%	13.62%	LARGE	72.8%
[redacted]						
CSX CORP	0.71	8.8%	13.84%	13.19%	LARGE	52.1%
NORFOLK SOUTHERN CORP	0.83	10.0%	13.57%	12.36%	LARGE	47.9%
UNION PACIFIC CORP	0.85	8.8%	12.46%	12.57%	LARGE	61.5%
MEDIAN OF ALL COMPANIES	0.89	9.00%	13.00%	13.00%		
MEDIAN OF LARGE CAP COMPANIES	0.89	9.36%	12.63%	12.98%		

CONCLUSIONS

Based on the indicators, it is my opinion that the cost of equity for large cap railroad companies with a typical capital structure is as follows:

	Minimum	Maximum	Point Estimate
Large Cap Companies (over $5,252 million)	12.0%	13.5%	13.0%

Based on this opinion and the size premia published by Ibbotson Associates, it is my opinion that the cost of equity for smaller railroad companies is as follows:

	Size Premia	Minimum	Maximum	Point Estimate
Mid Cap Companies ($1,115 to $5,252 million)	0.7%	12.7%	14.2%	13.7%
Low Cap Companies ($269 to $1,115 million)	1.4%	13.4%	14.9%	14.4%
Micro Cap Companies (below $269 million)	3.3%	15.3%	16.8%	16.3%

CAPITAL STRUCTURE

The typical market capital structure is estimated by comparing a company's market value of equity and market value of debt with its total market value of equity and debt. The market value of equity is estimated by multiplying the price per share times the number of shares. The market value of debt is estimated with the book value of debt. For use in calculating market multiples, a company's total market cap is the value of equity plus the value of debt less cash. Numbers published in ValueLine are used for number of shares, total debt and cash.

COMPANY	CHOSEN YR END PRICE	NUMBER OF SHARES	VALUE OF EQUITY (MILLION)	TOTAL DEBT (MILLION)	CASH (MILLION)	TOTAL MARKET CAP (MILLION)
BURLINGTON NORTHERN SANTA FE RR	27.48	365,874,903	10,026	6,684	20	17,290
CANADIAN NATIONAL RAILWAY	45.87	182,000,000	8,507	3,274	531	11,550
CANADIAN PACIFIC RAILWAY LTD	16.67	156,184,200	2,953	2,362	68	5,247
CSX CORP	35.29	213,162,313	7,520	6,907	592	13,835
NORFOLK SOUTHERN CORP	18.32	385,528,270	7,063	7,668	134	14,597
UNION PACIFIC CORP	54.15	248,406,619	13,451	8,404	120	21,735
AGGREGATE			60,420	35,299		
BURLINGTON NORTHERN SANTA FE RR			61.4%	38.6%		
CANADIAN NATIONAL RAILWAY			72.9%	27.1%		
CANADIAN PACIFIC RAILWAY LTD			55.6%	44.4%		
CSX CORP			52.1%	47.9%		
NORFOLK SOUTHERN CORP			47.9%	52.1%		
UNION PACIFIC CORP			61.5%	38.5%		
AGGREGATE			58.8%	41.2%		
TYPICAL		SAY	60.0%	40.0%		

COST OF DEBT

The cost of debt is estimated based on the S&P long term ratings for companies in this business sector, being mindful of the individual company's capital structures and the typical capital structure selected.

COMPANY	S&P LONG TERM RATING	S&P CORPORATE BOND YIELD	NOMINAL INCOME TAX RATE	AFTER TAX COST OF DEBT
BURLINGTON NORTHERN SANTA FE RR	BBB+			
CANADIAN NATIONAL RAILWAY				
CANADIAN PACIFIC RAILWAY LTD	A-			
CSX CORP	BBB			
NORFOLK SOUTHERN CORP	BBB			
UNION PACIFIC CORP	BBB-			
SELECTED AS TYPICAL	BBB	6.47%	39.0%	6.17%

WEIGHTED AVERAGE COST OF CAPITAL (AFTER TAX)	Minimum	Maximum	Point Estimate
Large Cap Companies (over $5,252 million)	9.3%	10.2%	9.9%
Mid Cap Companies ($1,116 to $5,252 million)	9.7%	10.8%	10.3%
Low Cap Companies ($269 to $1,116 million)	10.1%	11.0%	10.7%
Micro Cap Companies (below $269 million)	11.2%	12.1%	11.8%

MARKET MULTIPLES

Market multiples are calculated by comparing each company's total market capitalization to various levels of income. In this application, market multiples are developed for revenues, for earnings before interest, taxes,depreciation and amortization (EBITDA), and for earnings before interest and taxes (EBIT). Various financial ratios are also developed for each company for use in evaluating comparability to the company being valued. The amounts of income are these estimated for the next year.

INCOME DATA

COMPANY	TOTAL MARKET CAP (MILLION)	REVENUES (MILLION)	OPERATING MARGIN	EBITDA (MILLION)	DEPRE- CIATION	EBIT (MILLION)
BURLINGTON NORTHERN SANTA FE RR	17,289	9,280.0	31.0%	2,876.8	940.0	1,936.8
CANADIAN NATIONAL RAILWAY	11,550	3,550.0	43.5%	1,544.3	355.0	1,189.3
CANADIAN PACIFIC RAILWAY LTD	5,247	2,440.0	33.5%	817.4	230.0	587.4
CSX CORP	13,835	8,320.0	22.5%	1,872.0	640.0	1,232.0
NORFOLK SOUTHERN CORP	14,587	8,155.0	26.0%	1,600.3	520.0	1,080.3
UNION PACIFIC CORP	21,735	12,200.0	28.5%	3,494.1	1,200.0	2,294.1

MULTIPLES

COMPANY	REVENUES	EBITDA	EBIT
BURLINGTON NORTHERN SANTA FE RR	1.86	6.01	8.93
CANADIAN NATIONAL RAILWAY	3.25	7.48	9.71
CANADIAN PACIFIC RAILWAY LTD	2.15	6.42	8.93
CSX CORP	1.66	7.39	11.23
NORFOLK SOUTHERN CORP	2.37	9.12	13.51
UNION PACIFIC CORP	1.77	6.22	9.47
MEAN	2.18	7.11	10.30
MEDIAN	2.01	6.91	9.59

Many financial ratios can be developed from data already presented in this study. Additional data is presented below, followed by the computed ratios for each company. Following the financial ratios are definitions of each of the ratios. Other ratios with their definitions are then presented. All the ratios are considered as measurements of comparability to other companies.

ADDITIONAL DATA

COMPANY	TOTAL ASSETS (MILLION)	CURRENT ASSETS (MILLION)	CURRENT LIABILITIES (MILLION)
BURLINGTON NORTHERN SANTA FE RR	24,741	965	2,266
CANADIAN NATIONAL RAILWAY	18,801	2,009	1,638
CANADIAN PACIFIC RAILWAY LTD		743	762
CSX CORP	20,808	2,019	3,447
NORFOLK SOUTHERN CORP	19,385	893	2,383
UNION PACIFIC CORP	31,305	1,309	2,824

FINANCIAL RATIOS

COMPANY	PAYOUT RATIO	SALES TO TOTAL ASSETS	CURRENT RATIO	OPERATING MARGIN
BURLINGTON NORTHERN SANTA FE RR	21.3%	37.5%	43.8%	31.0%
CANADIAN NATIONAL RAILWAY	17.8%	18.9%	130.9%	43.5%
CANADIAN PACIFIC RAILWAY LTD	20.6%		98.8%	33.5%
CSX CORP	17.4%	40.4%	58.6%	22.5%
NORFOLK SOUTHERN CORP	22.9%	31.8%	37.8%	26.0%
UNION PACIFIC CORP	19.0%	39.2%	49.5%	28.5%

DEFINITIONS

PAYOUT RATIO	Next year's estimated dividend divided by next year's estimated earnings
SALES TO TOTAL ASSETS	Next year's estimated revenues divided by total assets from most recently available balance sheets
CURRENT RATIO	Current assets divided by current liabilities from most recently available balance sheets
OPERATING MARGIN	Next year's estimated EBITDA divided by next year's estimated revenues

OTHER RATIOS

COMPANY	ESTIMATED 3 YEAR COMPANY GROWTH
BURLINGTON NORTHERN SANTA FE RR	7.6%
CANADIAN NATIONAL RAILWAY	5.8%
CANADIAN PACIFIC RAILWAY LTD	-0.7%
CSX CORP	8.4%
NORFOLK SOUTHERN CORP	7.8%
UNION PACIFIC CORP	7.2%

DEFINITIONS

EST. 3 YEAR COMPANY GROWTH	Estimated 3 year earnings growth times the equity percentage of equity plus total debt.

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REVISED APPRAISAL

OF

THE FAIR MARKET VALUE

OF

ALL PROPERTY OWNED, OPERATED, OR USED BY

CSX TRANSPORTATION, INC.

IN PROVIDING RAILROAD TRANSPORTATION SERVICES

AND

ALLOCATION OF THE FAIR MARKET VALUE

TO THE TAXABLE OPERATING ASSETS IN GEORGIA

GREGG DICKERSON
PROGRAM MANAGER
GEORGIA DEPARTMENT OF REVENUE
PROPERTY TAX DIVISION

[Defendant's Ex. 14]

* * * *

Addendum E

A. Qualifications

I received my B.S.Ed degree from the University of Georgia in 1972. Since that time I have taken numerous courses and examinations involving the theories and methodologies of property valuation, have spoken and published on those topics, and have actively worked as a property appraiser. I am currently employed as Program Manager, Public Utilities Section, Property Tax Division, in which capacity I am responsible for determining fair market values for ad valorem tax purposes of operating property in Georgia owned by public utilities (including railroads) and certain other taxpayers.

In 1973 I successfully completed a training course in all aspects of real estate appraisal conducted by O. R. Colan and Associates, Orlando, Florida and sponsored by the Georgia Department of Transportation. I subsequently took and passed the American Institute of Real Estate Appraisers examinations for Basic Appraisal Theory (Course 1A), Introduction to the Income Approach (Course 1B), and Advanced Income Approach (Course 2).

For 18 of the past 19 years I have attended the Appraisal for Ad Valorem Taxation of Communications, Energy and Transportation Properties program sponsored by the National Tax Association and Wichita State University, which is the largest national educational program dealing with the theory of and current issues in the valuation of public utilities and railroads for property tax purposes. It is attended by several hundred people involved in this discipline from industry, academia, the consulting profession, and state and local governments. Speakers from these and other related fields present papers or participate in discussions on all topics related to the property taxation of public utilities, airlines, and

railroads. I have also been a frequent speaker at this program on such topics as the income approach, the use of market multiples and the stock and debt approach as they apply to unit rule valuation of public utilities and railroads, and I have been a member of the planning committee that annually reviews the questionnaires submitted by attendees of the program to decide on the topics and speakers for the next program, as well as the structure of the program.

I have been a frequent speaker at the International Association of Assessing Officers' Public Utility Seminars, which are devoted entirely to issues involving the valuation of property owned by railroads and public utilities, and annual conferences.

I have taught unit rule valuation methodologies at both state and national educational programs, including a 40 hour introductory course on the valuation of public utilities for property taxes at the Georgia Department of Revenue's Annual Short Course for county appraisers and a portion of the basic course taught at the Appraisal for Ad Valorem Taxation of Communications, Energy and Transportation Properties program sponsored by the National Tax Association and Wichita State University.

Articles that I have written on such topics as discounting of owner financing and application of the income approach in unit rule appraisals have been published in "The Appraisal Journal," "Assessment Digest", and "The Property Tax Journal," which are national publications in the property appraisal and property assessment fields.

I am certified as an Appraiser IV by the Georgia Department of Revenue's Georgia Certification Program.

From 1973 to 1983 I was employed by the Georgia Department of Transportation as a Right of Way Appraiser I, II, and Team Leader. In that capacity I prepared and reviewed appraisals of varied types of real estate for purposes of right-

of-way acquisition. I was employed by the Georgia Department of Revenue as Public Utility Valuation Manager from 1983 to 1993. In this position I prepared unit rule appraisals of all types of public utilities and railroads for Georgia ad valorem tax purposes. I was hired by Norfolk Southern Corporation in 1993 as a Property Tax Manager, where I was responsible for reviewing appraisals of the properties of Norfolk Southern's railroad subsidiaries made by the states in which those companies had property and negotiating unit valuations with them. In 2001 I returned to the Georgia Department of Revenue to assume my present position.

B. Prior Publications

The publications that I have authored within the preceding ten years consist of the following papers.

Published in the proceedings of the annual program on "Appraisal for Ad Valorem Taxation of Communications, Energy and Transportation Properties" sponsored by the National Tax Association and Wichita State University:

(1) "The Great Operating Lease Debate, or You Knit, Therefore You Are" (2000);
(2) "Estimating the Cost of Equity, or They Ripped Out My CAPM and Stomped That Sucker Flat" (1997)
(3) "Income to be Capitalized for Direct Capitalization, or Which Came First, the Chicken or the Egg?" (1992)
(4) "Metaphysics and NOI Growth: A Leap of Faith" (1991)
(5) "Unconglomerating the Conglomerate, or Dissecting a Frog with a Chainsaw" (1989).

I have submitted an article entitled "Advanced Cost of Capital Issues" for publication in the proceedings of the upcoming 2004 Wichita program.

Published in the International Association of Assessing Officers (IAAO) Annual Conference Proceedings:

(1) "Estimating The Cost Of Equity" (1997); and

(2) "Exploring Capitalization: Will The Direct Avenue Yield Sound Unit Values" (1995).

C. Prior Testimony

I have testified as an expert by deposition within the preceding four years in the following cases:

(1) *Florida Power & Light Co. v. Bart L. Graham, et al.*; Fulton Superior Court; Civil Action No. 2003CV77899. Deposed on the value of Florida Power & Light as of January 1, 2003.

(2) *CSX Transportation, Inc. v. The State Bd. of Equalization, et al.*; U.S. Dist. Ct (N.D. Ga.); Civil Action No. 1:02-CV-2634CAP. Deposed on the value of CSX Transportation as of January 1, 2002.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

No.1:02-CV-2634

CSX RAILROAD TRANSPORTATION, INC.
Plaintiff,

vs.

STATE BOARD OF EQUALIZATION,
Defendant.

TRIAL TRANSCRIPT

VOLUME II - MAY 17, 2005

BEFORE THE HON. CHARLES A. PANNELL, JR.

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WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
Gregg Dickerson	203	292	322	
Carl Martland	327	346	363	

* * * *

[206] Q. Now, just so I'll be clear, when you worked — Well, let me start off to be sure we are correct. The appraisals you are doing now or the work you are doing now at the Department of Revenue, for the most part, and certainly the appraisal you are doing in this case, is under the unit value methodology, correct?

A. In value, yes. In numbers of companies, it's probably the other way around.

Q. Sure. You do 200 private car lines, and you don't do those as unit values?

A. That's correct, and there are 300 of them.

Q. Okay. I knew there was a lot of them. But the big guys, the Georgia Powers, the BellSouths, the Atlanta Gas, that's the bulk of your digest, and you do those as a unit valuation?

A. That's correct.

Q. Okay. When you were at the Department of Transportation for those ten years, you didn't do any unit valuations?

A. No, sir.

Q. Okay. And I think you told me earlier that when you were at Norfolk Southern, you didn't do any unit appraisals?

A. That's correct.

Q. Okay. Now, you do not hold an appraisal designation from the Appraisal Institute, is that correct?

A. No, sir.

Q. And I think you have told me before that the only [207] appraisal course you have taken, formal course was one on real estate appraisal you took back in 1973?

A. That's correct.

Q. Okay. And did you also tell me that the appraisal that you have done in this case, the written appraisal, which was defendant's number 77, that's really the first formal written appraisal that you have ever done?

A. First formal written unit rule appraisal.

Q. Yes, sir. All right. So just to be clear, you have taken one formal appraisal course about thirty-two years ago in 1973, correct?

A. Correct.

Q. And that didn't involve unit appraisal at all?

A. That's correct.

Q. And the appraisal you are going to be presenting here is the first formal unit appraisal you have ever presented?

A. The first full written appraisal, yes, or narrative appraisal.

Q. Okay. Now, Mr. Dickerson, I want to talk about your valuation work sheet, that's plaintiff's exhibit number 32. Do you have a copy of that with you?

A. No, sir.

Q. Okay. Let's see if we can get you one. I'll give you this one and move this thing along. That's the work sheet that forms the basis of the proposed assessment in this case, is

* * * *

[257] correct problems that he saw with CSX.

THE COURT: Well, I agree with you that it may not be — it may not be determinative. It may be probative. So I'll overrule your objection.

MR. MCBRIDE: I believe I'm going to tie this together, Your Honor. I'll do my best.

THE COURT: I hope I'm there when you tie it all together, mentally.

MR. MCBRIDE: I'll do it as fast as I can.

THE COURT: All right. Go ahead.

Q. Okay. Now, just to make the point, if I look down to the other large company there, that's Norfolk Southern Railway Company, correct?

A. Norfolk Southern Combined Railway, yes, sir.

Q. Okay. And you increased their value between 2001 and 2002 by 19.88?

A. That's correct.

Q. And, again, looking across the page, I can show what's happened with respect to their Georgia taxable value, correct?

A. Yes, sir.

Q. Okay. Now, I believe you and I talked at deposition, and I don't want to have to go through all of these pages. But of the large taxpayers that you have in Georgia, the BellSouths, the Georgia Powers, nobody got an increase anything like the 47 percent or the 19 percent that the railroads got, right?

[258] MR. CALVERT: Just for the record, Your Honor, we renew the same objection.

THE COURT: Right, it is noted.

A. I believe that's true.

Q. We talked about that on deposition. Okay. And that's because you knew a lot about these railroads, and you knew how to go and try to determine what you really thought the value of these railroads was, right? You knew a lot about evaluating railroads, and you felt comfortable increasing these railroads by very significant percentages, didn't you?

MR. CALVERT: Your Honor, Mr. McBride is leading. He's got compound questions there. We would object to that.

THE COURT: Well, he is an expert witness. I think he can handle that.

MR. MCBRIDE: And, Your Honor, under 611, I'm entitled to lead this witness. He's the guy who did the appraisal against us.

THE COURT: I'm going to let ask you that question. Go ahead.

MR. MCBRIDE: Pardon me?

THE COURT: You are going to get to ask that one.

MR. MCBRIDE: Okay.

THE WITNESS: Could you repeat the question?

(Record was read as requested)

Q. You want me to break that down into some more questions,

* * * *

[297] MR. CALVERT: In that case, I didn't want to waive any objections by questioning from this document, but I'll proceed.

Q. Mr. Dickerson, on this particular document, the number I'm pointing to, the 9.7 billion dollar number for CSX?
A. Yes, sir.
Q. What does that represent?
A. That would have been my lower limit of value, of unit value for the year 2003.
Q. Okay. Now, what was your lower limit of value for 2002, for unit value?
A. The one that was in the valuation work sheets was 8.2 billion.
Q. And that's the number that was—the proposed assessment for 2002 was based on?
A. Yes, sir.
Q. Now, for 2003, was the proposed assessment against — issued against CSXT based on a unit value of 9.7?
A. Yes, sir.
Q. Okay. Now, following across on the same document, under the column marked CY unit value, and that reflects current year unit value, correct?
A. Correct.
Q. That shows 10.767 billion dollars. You see that number?
A. Yes, sir.
Q. And what does that number represent?

[298] A. That is my estimate of the lower limit of unit value for CSX Transportation for the year 2004.

Q. See the number under the column marked CY Georgia FMD?

A. Yes, sir.

Q. What does that number represent?

A. That represents the taxable Georgia fair market value for CSX Transportation for the year 2004.

Q. That's the number that was used in the proposed assessment for 2004?

A. Yes, sir.

Q. And just so the record is clear, would you read that number?

A.. 439 thousand, 58 thousand, 547.

Q. Is that 439 million?

A. Yes, sir, I'm sorry. 439 million, 58 thousand, 547.

Q. Now, is that 439 million dollar number derived from your unit value number of 10.767 billion?

A. No, sir.

Q. What is it derived from?

A. It is derived from the agreement, or settlement, whatever you want to call it, that the Department offered to propose to the various large utilities, including the railroads.

Q. Now, the 439 million dollar number reflected on that document?

A. Yes, sir.

[299] Q. You see what I'm talking about?

A. Yes, sir.

Q. That implies a unit value of how much?

A. I believe it was—I believe it was 6.5 billion.

Q. But not based on the unit value determination that you made for CSX for that year?

A. No, sir. That was not based on my valuation.

Q. But instead on this settlement or negotiations that you have just described?

A. Yes, sir.

Q. Now, when you decided in 2004 that the way in which you calculated your cost of equity needed to be modified, did that uniformly result in a cost of equity that would go down?
A. Yes, sir.
Q. How did that affect the 6.5, or how did that play in the 6.5 billion dollar number that was used for the proposed assessment for CSXT for 2004?
A. There is no connection.
Q. And that's why?
A. Because the 6.5 billion is not a number that I originated.
Q. That's a negotiated number?
A. Yeah. It is the number that the commissioner decided to base the 2004 assessment on.
Q. Now, let me ask you about 2004 and discussions that the [300] Department had with public utilities, including CSXT for that year. Were you part of those discussions?
A. Yes.
Q. Could you describe what meeting or meetings you attended?
A. I attended several meetings with the commissioner in which he indicated that he had been approached by several of the large Georgia utilities, who indicated that if my values were used, that they would be filing appeals for the year 2004.
Q. What did you anticipate that would mean in terms of additional litigation?
A. I guess at least, well, at least three from that, I would imagine, would have been more of 10 to 20.
Q. 10 to 20 tax appeals challenging the Department's proposed assessments?
A. Yes, sir. And that's just an assumption that they would kind of follow along with the big ones.
Q. Now, based on the information that the Department was getting from public utilities, was a meeting held with them?
A. Yes, sir, a meeting with Georgia Power, BellSouth, Atlanta Gas Light, Delta Airlines, and CSX Transportation,

Norfolk Southern Railway was held between those companies and the commissioner, and I attended that meeting. I can't remember if anybody else from the Department was in there, but I believe there was at least one additional person. The commissioner held that he had devised, I guess, well, he had [301] devised what he was going to offer these companies.

Q. Before you go on, let me just to make sure the record is clear. Is that a meeting that took place before the Revenue Department issued its proposed assessments?

A. Yes, sir.

Q. So the process, as I understand it, is that is that you prepare valuations or proposed valuations of the public utilities, and only after that point are the proposed assessments presented to the State Board of Equalization and then issued, is that accurate?

A. Could you repeat that, please?

Q. Sure. For example, looking at the document that is up on the screen, the 10.7, the 10.767 unit value for CSXT, that number was not used in calculating the proposed assessment for 2004, correct?

A. That's correct.

Q. Okay. Is that a number that you would have shared with CSXT at some point?

A. Yes. It was standard practice while I was working on the valuation work sheets, that particularly the major companies would want to come in and get sort of a preview, see if there was any information they could furnish that would change my opinion, and we discussed the value as to what that unit value ought to be.

Q. The process as you have described it, was that designed [302] to get the taxpayer's input as to your values before they were formalized in the way of a proposed assessment?

A. Yes, sir. It was an attempt to reach agreement prior to that point.

Q. So the meeting that you have been—that I have asked you about with sort of the public utilities, including the

railroads, that took place after you had come up with valuations of what you thought the unit values of these companies were, but before those numbers had been presented to the State Board of Equalization and put in a proposed assessment?

A. That's correct.

Q. Okay.

A. And let me go back to one of my answers. I'm not sure that that number was shared with CSX that year. I just can't remember whether we actually had discussions that year or not.

Q. Now, the meeting that we started to talk about, representatives of CSXT were at that meeting?

A. Yes, sir.

Q. Do you recall who was there on behalf of CSXT?

A. I believe it was David Boeing and Kerry Carnahan.

Q. And Mr. Carnahan holds what position at CSXT?

A, I believe he's a director of taxation. I believe it's more than just property taxation.

Q. Could that be a position of CSX Corporation at [303] the corporate?

A. Yes, yes.

Q. What were the discussions at that meeting?

A. I believe the commissioner did most of the talking. He started out the meeting expressing his concern with the level of disagreement, and that he basically wanted to—Well, he first started the meeting saying he wants to present these—some way of avoiding the litigation.

MR. MCBRIDE: This is all hearsay. He is telling us what the commissioner said.

MR. CALVERT: It's not for the truth of the matter stated. This is what the conversation was.

THE COURT: Right.

MR. MCBRIDE: It's not for the truth of the matter stated? I don't know where it's going.

THE COURT: I don't either, but go ahead.

Q. If you would, please.
A. Okay. The commissioner held, or started the meeting with saying — thanking everybody for coming, first, and said that basically the purpose was to see if there wasn't some way that the Department could avoid this onslaught of litigation, and give the parties additional time to discuss the issues, and see if some of the issues couldn't be resolved, and hopefully put that into place before the next year.

One of the things was that—The commissioner [304] basically asked the members present that if they agreed to go through this process, that any settlements reached would not be used for any purposes except this settlement and would not be used in prior or future litigation as binding.

MR. CALVERT: And before you go any further. Your Honor, the reason we are going into this at all is because Mr. McBride has brought up 2004. We agree that we don't think it is relevant. But since he's interjected it into the case, we want to make sure that it's clear on the record that what happened, the numbers that came out of the discussions for 2004 were compromise numbers. And that they were — and they don't indicate anything about where CSXT's true market value should be for 2002. So, I mean—

THE COURT: I understand your position.

MR. CALVERT: So I won't—We won't belabor this much, but I just wanted to make the record clear.

Q. What was the proposal that was made by the commissioner?
A. Basically, for the four members, well, I'm sorry, for the three members, other than the railroads, and Delta Airline, which isn't formed on the unit rule valuation, it's a plan by

plan valuation, that this year, that the 2004 Georgia taxable fair market value would be the higher of the 2003 Georgia taxable fair market value, or an average of the 2001, 2002 and 2003 Georgia taxable fair market value.

Q. Were those the values, when you say the 2003 or the prior [305] three years' taxable values, were those the values as they would have been accepted by the taxpayers for those years?

A. Yes, sir.

Q. Okay. Now, where did that—Were there any subsequent discussions with either of the two railroads as to how they could be included in that type of resolution for 2004?

A. Yes. As I remember, the other parties were dismissed. The representatives of the railroads stayed on. And there was—Well, during the whole meeting it was recognized that the railroads didn't have the three prior years of finalized values.

Q. And why is that?

A. Because 2002 and 2003 values were under appeal.

Q. By both railroads?

A. By both railroads.

Q. I say both railroads, you mean?

A. Norfolk Southern and CSX Transportation.

Q. Okay.

A. So the discussion ensued as to how to handle the two railroads in some equitable manner, some manner consistent with this prior three-year average. And the general guidelines when we left the meeting was that since the last agreed-upon value was 2001, that this number probably ought to consider some increase for time for the three years that had elapsed. Exactly what that number was wasn't settled at the meeting. [306] The railroads—Because of the time factor, this commissioner was very concerned with getting these—this digest out timely during July, and these meetings were in the middle of July. The proposed values for the other utilities was presented to them at the meeting. The two railroads were

requested to go back, come up with a number, with a suggestion that it be the 2001 plus some increase for time, and to respond back to the Department. And I forget, I think this was early to mid week, respond back by the next Monday as to what that number would be, what they could agree to, so that we could turn around and turn out this digest the next day. Norfolk Southern responded, I believe, that Friday, and proposed a number. The number was basically the same as the 2001 value, and I guess I made the decision that that was good enough.

Q. What about CSXT?

A. CSXT did not respond, and I was left to a comment I had heard at the meeting, I believe made by Kerry Carnahan, that something in the area of 6.5 billion might be reasonable.

Q. Or would be acceptable to CSXT?

A. Again, I don't think Kerry or anyone was agreeing at the meeting, but he was sort of presenting it as something he thought his management would agree to. When I didn't get a response by noon Monday, I think the deadline was, in order to get the numbers crunched through the system, and get the assessments out, or get the digest to the board the next day, I [307] used the 6.5 as a basis for the 2004 assessment.

Q. Did CSXT appeal that assessment for 2004?

A. No, sir.

Q. Mr. Dickerson, I'm going to quickly go through a few points that were touched on by Mr. McBride in his questioning of you. You have—At different times during your testimony we have referred to your full appraisal or your complete appraisal as distinguished from the document which I believe is plaintiff's exhibit 32 and defendant's exhibit 13. Why do you distinguish those two documents in the way you refer to them?

A. Well, mainly it's the narrative portion. The distinction—There is a distinction between the amount of effort that goes into it, but the main difference is the narrative that you would include within an appraisal, whenever you are going to turn

an appraisal over to a client. Typically, since I am my own client, I guess, we don't prepare narrative appraisals. We only go through the valuation work sheets. Now, depending on the scope of the research you have done prior to that, that could be a preliminary number. But as the appraisal, as both appraisals show, I mean, the valuation work sheets later serve as an addendum to the narrative appraisal, and the narrative appraisal merely refers to sections within that valuation work sheet.

Q. Now, Mr. Dickerson, how many unit valuations have you performed—have you performed during your professional [308] career?

A. Well, I would perform—

MR. MCBRIDE: I want to be sure I understand what he means by valuation. We have an issue about that. If he could just explain what he means by valuation.

MR. CALVERT: I'll do that, Your Honor.

THE COURT: All right.

Q. How many companies have you valued using the unit rule?

A. I would guess it's approximately, today, it's probably 150 companies a year. It would have been—and that's probably true for the last three years. In my ten prior years at the Department of Revenue, that number was probably more like 110 to 120, the difference being the large increase in the number of telecom companies.

Q. So 120 to how many a year?

A. 120 to 150 a year.

Q. That would be a rough estimate of the number of companies you have valued under the unit rule during your entire professional career?

A. Yes, it would be that times thirteen years, I guess.

Q. Okay. Now, there was also some discussion during your testimony earlier today about a range of fair market value

versus a point estimate of fair market value. Could you explain again the—or explain for us now the difference between those concepts?

* * * *

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

No.1:02-CV-2634

CSX RAILROAD TRANSPORTATION, INC.
Plaintiff,

vs.

STATE BOARD OF EQUALIZATION,
Defendant.

TRIAL TRANSCRIPT

VOLUME III - MAY 18, 2005

BEFORE THE HON. CHARLES A. PANNELL, JR.

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VOLUME III

Pages 365-517 - May 18, 2005

WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
Thomas Tegarden	368	429	514	

* * * *

[369] Q. Do you hold any appraisal designations?
A. Yes, I do.
Q. What are they?
A. I hold the MAI appraisal designation from the American Institute of Real Estate Appraisers, now known as simply The Appraisal Institute, and it is considered the highest appraisal designation offered in the field of appraisal. I also hold the CAE, Certified Assessment Evaluator, from the International Association of Assessing Officers, it is also the highest designation offered by that organization as well. I also am a Tennessee Certified General Appraiser and a licensed appraiser, and I also hold licenses similar to that in the states of Michigan and Minnesota.
Q. How long have you been doing this appraisal work?
A. A little over thirty-five years.
Q. In doing this appraisal work, do you always represent utility companies?
A. No, sir.
Q. What other kind of entities do you represent?
A. Well, we do appraisal work, consulting work, property tax type work for both sides of the property tax paying spectrum. We have clients, for example, the Wyoming Department of Revenue, we have worked for the New Hampshire Department of Revenue, the Florida Department of Revenue, Georgia Department of Revenue, Colorado Department of Revenue, South Dakota [307] Department of Revenue, and Dallas County, Texas, Anchorage, Alaska, Valdez, Alaska, just various tax administrative organizations.
Q. All right. That's fine. And you—In addition to those, I take it you represent companies like CSXT here?
A. Yes, sir, we do.
Q. Do you represent companies like BellSouth?
A. BellSouth, AT&T, Quest, Southwestern Bell, Georgia Power.

Q. And you do that work on an annual basis for them, is that right?

A. Yes, sir.

Q. Okay.

A. As a rule, that's correct.

Q. Now, you said you did some work for governmental agencies. Could you describe for me generally what kind of work you do for governmental agencies?

A. Well, the same type that we do for property taxpayers. A lot of times for governmental agencies, we will speak to legislators, or speak before legislative committees, or teach public utility basic appraisal courses, etcetera. That's one of the things we do a lot of for state departments of revenue.

Q. And when you teach, do the state people come to those courses?

A. State people, as well as property taxpayers, and judges, legislators, various individuals that are interested in this [371] field.

Q. In addition to teaching in those kind of situations, do you have an occasion to teach appraisal of utilities in some other context?

A. Yes. For the Wyoming Department of Revenue, we actually wrote an appraisal course that we have taught to several different departments of revenue around the country, and we go out there annually as a rule and teach, put on a course that we limit to twenty-five students from around the country on a first come first serve basis, and teach them basically the appraisal principles involved in ad valorem tax valuation of public utilities and railroads.

Q. And do you ever attend the Wichita Workshop?

A. Yes, sir. I have attended every one of them. There has been something like, I think, thirty-four of them now and I have attended all of them, and have taught at most of them.

Q. What's the Wichita Workshop?

A. The Wichita Workshop is a workshop at the Wichita State University that is dedicated specifically to the ad

valorem tax valuation of public utilities and railroads. It's attended by probably 400 to 500 people a year from around the country that are interested in this field, tax administrators as well as taxpayers, and occasionally judges and legislators, that sort. But it's the only workshop of its kind really that's dedicated to this type of work that's sponsored by a state university, [372] and is put on with all types of people coming to it regularly and in large numbers.

Q. Mr. Tegarden, before you began Thomas Tegarden and Associates, what did you do?

A. For fifteen years I worked at the Tennessee Public Service Commission, and the Tennessee Public Service Commission was one of two commissions in the nation that did the ad valorem tax valuation of public utilities and railroads in addition to setting their intrastate rates. I worked as the assistant director of assessments there for about eleven of the years, and all totaled I worked there for fifteen years before I started my own appraisal business.

Q. So you have been in your own appraisal business for what, about twenty years?

A. Twenty-two, twenty-three years, yes.

Q. Okay. All right. I want to see if we can try to get—put this case in perspective, and I want to talk a little bit about appraisal. And I want to take a little bit of time, if we can this morning, to kind of go through the appraisal process and talk a little bit about appraisal principles and the unit assessment. First, is your objective in this case to determine the market value of property?

A. Yes, sir.

Q. And what definition of market value do you use?

A. Well, we list it on the very first page of our appraisal,

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

No.1:02-CV-2634

CSX RAILROAD TRANSPORTATION, INC.
Plaintiff;

VS.

STATE BOARD OF EQUALIZATION,
Defendant.

TRIAL TRANSCRIPT

VOLUME IV - MAY 19, 2005

BEFORE THE HON. CHARLES A. PANNELL, JR.

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* * * *

[578] strategic plans, or any budgeting information, or anything like that in our annual filings.

Q. Okay. So you are familiar with what other states were doing for CSXT in 2002, which is the assessment year, correct?

A. Yes.

Q. Now, Mr. Dickerson said that he was trying to find the lowest estimate of value he could come up with, his 8.2.

MR. CROSSETT: I object to the form of the question, Your Honor. Mr. McBride is trying to characterize testimony from another witness.

MR. MCBRIDE: I'll rephrase my question, Your Honor.

THE COURT: All right.

MR. MCBRIDE: I'll just ask you very quickly.

Q. Of the fifteen states that you have that do a unit value, is Mr. Dickerson's value the lowest?

A. No, it's not.

Q. Is it the highest?

A. It exceeds the highest, yes.

Q. All right. Thank you. Now, I want to talk to you very quickly—I want to talk to you just very quickly about the Georgia assessment. Do you have a copy of exhibit 8 with you, Mr. Carnahan?

A. I do.

Q. Okay. And did you at my request prepare exhibit 8?

A. I believe I did, yes.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
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No.1:02-CV-2634

CSX RAILROAD TRANSPORTATION, INC.
Plaintiff,

VS.

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Defendant.

TRIAL TRANSCRIPT

VOLUME V - MAY 20, 2005

BEFORE THE HON. CHARLES A. PANNELL, JR.

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Hal Heaton	683	699		
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Gregg Dickerson	764			

* * * *

[765] Q. Now, Mr. Dickerson, I have handed you what's been marked and admitted at defendant's exhibit 14, and if you will turn to addendum E to that document.

A. I have it.

Q. And can you tell me, does addendum E accurately describe your professional experience and training in the field of property valuation?

A. Yes, it does.

Q. And would you briefly take us through that, please?

A. Basically as far as formal education, I received my BSED degree in math education from the University of Georgia in 1972, as far as education. I taught for a year, then joined the Department of Revenue and was sent to a training course in all aspects of real estate appraisal that was like, I think, an eight to ten week course.

Q. Now, you said the Department of Revenue. Is that the Department of Transportation?

A. I'm sorry, Department of Transportation. Thank you. Upon completing that course, I subsequently challenged or took and passed the American Institute of Real Estate Appraisers exams for course 1, course 2—I'm sorry, course 1A, which is basic appraisal theory, course 1B, which is an introduction to the income approach, and course 2, which is the advanced income approach.

Q. Now, how long were you employed by the Georgia Department [766] of Transportation?

A. Approximately ten years.

Q. And that was as an appraiser?

A. Yes, sir. I started as a right-of-way appraiser 1. At the end of the term, I was a right-of-way acquisition team leader, which just meant that I—besides preparing appraisals, I was responsible for an acquisition team that handled both the appraisal and acquisition of needed right-of-way parcels.

Q. Approximately how many property valuations did you perform while you were with the Georgia Department of Transportation?

A. Several hundred. Typically, a right-of-way acquisition project will have maybe fifty to a hundred parcels, of which there may be one or more appraisers assigned to. It would be hard to put a number on those.

Q. Now, how long were you with the Georgia Department of Transportation?

A. Ten years.

Q. And after that, where did you go?

A. I joined—I went with the Georgia Department of Revenue as the Public Utility Valuation Manager.

Q. And you were hired to do then essentially what you are currently doing now?

A. Yes, sir.

[767] Q. You were hired by Ms. Judith Ross?

A. That's correct.

Q. And what year was that?

A. That would have been about approximately 1983.

Q. Now, what I will refer to as your first stint with the Revenue Department lasted from about 1983 until when?

A. 1993, approximately ten years.

Q. Now, during that ten-year period, were you involved in property valuations?

A. I would say the first year I was involved in property valuations. When I noticed what the Department was doing at that time, it became—and upon studying what the unit rule meant, it became apparent that the Department was not doing the unit rule as I perceived it, which was basically to value the business. And so during that first year, I was changing the way that the Department did it, so by the next year, I would call what I did from that point on business valuations.

Q. Under the unit rule?

A. Yes, sir.

Q. And approximately how many of those types of valuations did you perform before you left the Revenue Department?

A. I would say over the ten-year period, over a thousand.

Q. Now, you have been here during all the testimony in this trial so far, haven't you?

A, Yes, sir.

[768] Q. Did you hear Mr. Tegarden testify regarding the Wichita workshops?

A. Yes, sir.

Q. Tell us again, would you, what the Wichita workshops are.

A. Basically the Wichita workshop, it is sponsored by the National Tax Association and Wichita State University. It is, I believe, the largest gathering of this type for people involved in this field. It's attended by both state administrators, company tax representatives and tax consultants. And it serves as sort of an exchange of ideas. The program, they attempt to keep it balanced, and normally a program, there will be segments on particular issues that are in, I guess, in controversy. And the program will attempt to have one person that represents each side of a particular controversy and present those to the audience.

Q. Do the topics that are covered include the various valuation methodologies that should be used in arriving at unit valuation of public utilities?

A. Yes, sir, they do. They cover all the approaches. They even have had segments on allocation, some of the minor issues. But the programs do tend to focus on the income approach and market approaches, as those are sort of the sources of the main controversies.

Q. Now, I think you mentioned, how often have you attended that conference?

[769] A. I attended it, I believe, out of the past twenty, twenty-one years, I have missed that conference twice, as of now.

Q. Now, have you also been a presenter at that conference?
A. Yes, sir. I have been a frequent presenter on the main program. Again, most of the topics that I presented have been regarding the income approach, or the market approach, and did one year assist Mr. Tegarden in the presentation of the basic course, I think, trying to remember, I think as my segment of that, I think I presented the cost approach.
Q. And as it applied in the unit value context?
A. Yes, sir, and as written in that course.
Q. So you and Mr. Tegarden were like co-presenters or co-panelists?
A. Mr. Tegarden is in charge of the basic program out there, and I was just asked to present a small part of it.
Q. Were you asked by Mr. Tegarden to do that?
A. I really don't think it was directly from Mr. Tegarden. Again, the planning committee likes to vary the presenters even within the basic course, just to get sort of new blood into that program.
Q. Now, have you taught unit rule valuation methodologies in any other settings?
A. Yes. During my first stint with the Department of Revenue, I developed and taught a course for two years on the [770] valuation of public utility properties. It was taught to the—during what the Department calls a short course, which is a week-long session held at the University of Georgia, where various courses are taught both by Department people, and I believe they also teach IAAL courses for the local assessors.
Q. Are you also published in your field?
A. Yes. I have—Well, I have been published in the property—let me see here. Been published in the "Appraisal Journal," the "Assessment Digest," and the "Property Tax Journal," which are monthly publications. The first one is one of the, I believe, published by the American Institute of Real Estate Appraisers. That, of course, didn't deal with unit valuation, it dealt with, at the time, it was a time during which

there was some creative owner financing going on, and it was a method of adjusting for that creative financing.

Q. Those publications that you mentioned, are those national publications?

A. Yes, sir.

Q. Now, you have testified that you were with the Revenue Department from I believe 1983 to 1993, is that correct?

A. That's correct.

Q. What did you do after that? Where did you go?

A. In 1993, I was employed by Norfolk Southern Corporation as a property tax manager.

Q. Now, when did you return to the Revenue Department?

[771] A. I returned late 2001.

Q. Were you approached by the Department?

A. Yes, sir.

Q. And who approached you about returning?

A. Well, I was approached several times by Mr. Joseph Slappy, who was doing this job, basically. He was more or less pleading with me to come back, that he no longer wanted to do this job. And then on one of my visits to the Georgia Department of Revenue, Mr. Larry Griggers, who we [sic] the director of the Department at that time, called me into his office, asked if I would be interested in coming back, and we talked about it.

Q. What did Mr. Griggers tell you he wanted you to come back and do?

A. He expressed a concern what had been happening as far as the valuation of public utilities since I had left. His concern was that he had looked at the digest through that period and had noticed that the public utility digest when I left was approximately 10 percent of the total state property tax digest, and had fallen to about 5 percent of the total digest.

Q. Did you suggest anything that you could do to correct that situation?

A. I expressed interest in returning, although I told him if his interest was in raising the numbers, I would not come

back [772] for that purpose. If his interest was in getting it right, I would be interested in returning, if he could come close to matching my salary where I was.

Q. Did Mr. Griggers match your salary and your conditions?

A. He matched my conditions, and he came close to matching my salary.

Q. All right. Now, when did you actually return to the Revenue Department?

A. I believe it was either August or September of 2001.

Q. So were you involved at all in the setting of the public utility proposed assessments for the tax year 2001?

A. No, I was not. And I believe at that time it hadn't been presented to the State Board, but Mr. Griggers desired that I not become involved in that digest, so that I could have a clean start in 2002 and not be tied to anything the Department had done prior to that.

Q. But you were involved in setting values for 2002, correct?

A. Yes, sir.

Q. And it was solely your responsibility to do the valuations that led to the proposed assessments for 2002?

A. That is correct.

Q. Now, after you came back to the Revenue Department and began to review the methods that were being used, or how they were being applied, what changes, if any, did you make?

[773] A. Well, the Department at the time was doing a yield capitalization in a form that is commonly called today capitalized earnings, where you convert a first year's estimated free cash flow by a cost of capital minus growth rate. They were also doing what was labeled as a direct capitalization method, where they were using the band of investment similar to the method used in the weighted average cost of capital to combine things like a EP ratio, the inverse of PE ratio with a cost of debt as being—that

representing a direct relationship between earnings and price, and they were doing a stock and debt.

They were basically—These approaches, I think that I instituted, replaced those. They are, I guess, theoretically comparable, but they are the form that is commonly used in business valuation. I replaced the discounted earnings, I'm sorry, capitalized earnings approach for the discounted cash flow; replaced what has been labeled as direct capitalization with the market multiples approaches, and kept the stock and debt.

Q. And why did you institute those changes?

A. During my absence, I had the opportunity to look at a great many documents. I was at Norfolk Southern when the Conrail merger or acquisition took place. I was able to review the procedures that were done by the various providers of fairness opinions in that transaction, and it was my desire to [774] replicate the method actually used in the marketplace.

Q. To arrive at values?

A. To arrive at values.

Q. Now, did you make any changes in terms of what type of income figures or data were used in performing these methodologies?

A. Yes. There are—The state of Georgia, like most states, have historically relied on regulatory reports as our sources of income information and cost information. I found out, again, while working at Norfolk Southern that investors in the railroad case, at least, rarely even know what an R1 is. It's not something that they look at in determining their analysis of a railroad company.

They look at the annual reports to stockholders, the 10K's filed with the Securities and Exchange Commission. That was the type of information they were interested in, and, again, to replicate the actions of the market, I thought they were a better source of income information.

Q. So in doing your railroad valuations for 2002, did you change from using R1 type of data to using data from another source?

A. Yes, sir. I changed to using the—what's reported in their annual reports as the rail segment.

Q. Now, you testified earlier this week concerning the 2002 public utility digest, and the increase in value that CSX [775] experienced from 2001 to 2002. Do you recall that testimony?

A. Yes, sir.

Q. Can you give us a general idea of what accounted for that increase in value?

A. Of course, there would be a difference in the markets from one year to the next, but in terms of this case, a big driver of the difference was the change in the source of the income information.

Q. And that's the change from R1 data to annual report data?

A. Yes, sir.

Q. Mr. Dickerson, I have handed you what have been admitted into evidence as joint exhibit 2 and joint exhibit 11, and if you will look at joint exhibit 2 first and tell me what that document is.

A. This is the 2001 annual report to stockholders of CSX Corporation.

Q. Now, is that a document from which you would have gotten income figures used in determining your values for 2002?

A. Yes, sir, it is.

Q. Now, if you will turn to page 18 of that document. Have you found that page?

A. Yes, sir.

Q. And tell me, what income numbers would you have been looking at on this chart at the bottom of the page?

A. Okay. I basically would have been looking at all the [776] numbers in the left hand most column under the heading, rail. I would have used that as source of revenues,

expenses, and calculated from that an offering or net revenues from railway operations as the term is in the RI's, but here it is called operating income. That would have been—Of course, as I went through the expenses, there is a 60 million dollar charge for the New Orleans litigation, which is a type of special charge or non recurring charge that I would have eliminated.

Q. But the line here for operating income, 746 million dollars, see that?

A. Yes, sir.

Q. That's the operating income indicated on this document for the rail segment of CSX Corp.?

A. That's correct.

Q. Is that basically the income number that you are going to be working from?

A. Yes, sir.

Q. Okay. If you will keep that page open. And if you will look at joint exhibit 11, CSXT's R1 report for 2002, and if you will find page 16 of schedule 210. Have you found that?

A. I have it, sir.

Q. See if I can make this work. Okay. Now, can you point to us—point to the line that shows railway operating revenues on this R1 report.

A. Yes, that would be line 13. If you will come across to [777] the amount for the current year, would be the 6,082,282,000.

Q. And what's the corresponding number on the annual report?

A. 6 billion 82 million.

Q. So it's the same number?

A. Yes, sir. In the annual reports, they round to millions. RI's, they round to thousands.

Q. Now, on the R1 report, would you direct us to the line which shows the total railway or the railway operating expenses?

A. Yes, sir. That is line 14, and, again, if you follow that over to the first column, that would be the amount for the current year, the 5,623,637,000.

Q. Now, what's the comparable number on the annual report?

A. On the annual report, the annual expenses are 5 billion 339 million.

Q. So on the R1 report, what is the amount shown for net revenue from railway operations?

A. That would be 458 million, 645 thousand.

Q. And that is basically line 13 minus line 14, correct?

A. Yes, sir, and shown on line 15.

Q. So that's 458.6 million dollars?

A. Yes, sir.

Q. And how does that compare with the operating income shown for the rail segment on the annual report?

A. On the annual report, that's 743 million, a difference of [778] roughly, well—

Q. Right around 285?

A. 285 million.

Q. Okay. So, just so it is clear, the operating income numbers that you worked from for 2002 would have been reflected in the 743 million dollar figure on the annual report, correct?

A. That's correct.

Q. As opposed to the net revenue from railway operations of 458 million dollars shown on the R1 report?

A. That's correct.

Q. Now, explain again why you decided to go with the figures on the annual report instead of the R1 report.

A. Again, the R1 is a regulatory report. It was my observation while at Norfolk Southern that investors don't look at and in most cases don't even know that that report exists.

Q. Now, had you been employing the same methods or techniques for 2002 that the Department had been using for 2001, which income number would you have used?

A. I still would have used the numbers out of the annual report.

Q. Perhaps I didn't make it clear. If you had been—perhaps the way to put it better. If your predecessor had been applying the technique for 2001, the same technique he used in 2001 to determine the 2002 valuations, which number would he have been looking at?

[779] A. I assume, since he hadn't made any changes during his tenure there, that he would have used the numbers out of the R1.

Q. Which would be the 458 million dollars?

A. That's correct.

Q. And very quickly, I'm going to hand you joint exhibit 1 and joint exhibit 10, and we are going to look at the same numbers for 2001. If you will look at joint exhibit number 10. First, you recognize that as the R1 report for CSXT for 2000?

A. Yes. This is the R1 for the year ending December 29th, 2000.

Q. If you will find page 16 of schedule 210 on that document. You see that?

A. Yes, sir.

Q. Okay. Again, point out the pertinent data on that R1 document, or the data that the Revenue Department would have been using for 2001.

A. Yes. Again, we would be working off the net revenues from railway operations.

Q. And that's line 15?

A. Line 15 in the R1, that is 323 million—well, 323.9 million.

Q. Okay. Now, on the annual report for that year, if you will turn to page 16.

A. I have it.

[780] Q. And what is the—I'll say comparable figure. It's not comparable, but what is the—what's the figure shown here for operating income for the rail segment on the annual report?

A. The corresponding number is the operating income of 615 million.

Q. Okay. And, again, is the difference between these, the numbers shown on the annual report and the numbers shown on the R1 report what those respective documents report as operating expenses?

A. It reflects what their operating expenses were reported, yes.

Q. So for regulatory purposes, CSXT is showing the same operating revenue both on the R1 as it is showing for the rail segment in the annual report, correct?

A. That is correct.

Q. And the difference is for regulatory purposes on the R1, it is showing larger, and significantly larger, operating expenses than is reflected on the annual report for the rail segment?

A. Yes, sir.

MR. CALVERT: Ms. Martin, could I get plaintiff's exhibit 32?

Q. Now, I have handed you a document we have talked about a little bit already in this proceeding, and I will try not to belabor the testimony about it, but I want to make sure the

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IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF GEORGIA
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CAUSE NUMBER 1:02-CV-2634

CSX RAILROAD TRANSPORTATION, INC.
Plaintiff,

VS.

STATE BOARD OF EQUALIZATION,
Defendant.

TRIAL TRANSCRIPT

VOLUME VI - MAY 23, 2005

BEFORE THE HON. CHARLES A. PANNELL, JR.

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VOLUME VI

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WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
Gregg Dickerson	857	987	1023	1030
Carolyn Sizemore	882	915		
Fredrik Eliasson	919	977	984	

• • • •

[886] Q. The company wouldn't expect to see that type of charge on an ongoing basis?
A. Would not.
Q. Would not.
A. That's right.
Q Ms. Sizemore, I have handed you what has been marked as joint exhibit 8, and can you identify that document?
A. It is the CSX Transportation's 2001 form 10K.
Q. CSXT and CSX Corp. file separate 10K's, correct?
A. That's right.
Q. This is the one for T?
A. That's right.
Q. Can I get you to turn to page 12 of that document? Is that the same page I have got up on the screen?
A. Yes, it is.
Q. Now, the operating income shown on this document of 459 million is different from the operating income shown on the 2001 annual report for the rail segment, correct?
A. That's right.
Q. So, is it correct to say for 2001, CSX Corp.'s management would not have viewed the performance of the company's rail segment as being reflected by the 459 million dollar operating income shown on the 10K for CSXT?
A. That's right.
Q. Now, I have handed you joint exhibit 11. Can you [887] identify that document?
A. It is the Ri report for CSX Transportation for the year 2001.
Q. Now, if you could take a moment and find page 16, schedule 210.
A. Okay.
Q. Now, if you will look at line 15 on that page, which shows net revenue from railway operations, 458 plus million dollars. Do you see that line?
A. 458 plus—What did you just say?

Q. 458 million.
A. Oh, I have got you.
Q. Plus?
A. It's billions, because this is in thousandths.
Q. The net, on line 15?
A. Right.
Q. That's 458 million 645 thousand, correct?
A. Yeah, I'm sorry, that's right.
Q. Now, that's essentially the number that is shown on the 10K for CSXT's operating income, correct, the 458 million?
A. I actually would need to spend some time with this document to compare those two.
Q. But the amount is essentially the same?
A. It looks like the same amount rounded.
Q. Well, let's look at it a little more closely. The amount [888] on this document, which is shown for—on line 10 for railway operating revenues, which is 6.082 billion, you see that amount?
A. I'm sorry. Can you repeat the question?
Q. Yes, on line 10. It shows railway operating revenues of 6.082 billion.
A. Uh-huh.
Q. See that?
A. Yes.
Q. That's the same amount that is shown as operating revenues on the 10K for CSXT, correct?
A. Okay, yes.
Q. Okay. And the railway operating expenses on line 14 of the R1 are 5.623 billion dollars. You see that number?
A. Yes.
Q. That's the same operating expenses as shown on the 10K for CSXT, correct?
A. That's correct.
Q. So it would be fair to assume then that the net revenue from railway operations shown on the R1, which is just the

difference between the expense number—the revenue number and the expense number is the same as the operating?

A. Yes.

Q. On the 10K?

A. Yes.

[889] Q. As a consequence, the 458 million dollar number shown as net revenue from railway operations on the R1, would also —that would not be reflective of management's view of the operating performance of CSX's rail segment?

A. This is not talking about the rail segment. This is only talking about CSX Transportation legal entity, so different rules govern this report, and you don't have to show this report in those same segments that the SEC requires.

Q. I understand that, but as a consequence that number on line 15 would not reflect the management's view of what the operating performance of the rail segment is?

A. I would not be comfortable saying as a consequence. That's not how the company views performance at the railroad.

Q. Did you say you would not. Could you read that answer back, please?

(Record read as requested)

Q. Would you agree that to the extent that the net railway from railroad operations number is a different number than the operating income that is shown on the rail segment of the annual report, that to the extent there is a difference between those numbers, management's view of how you measure the operating performance of the rail segment is the number shown in the annual report and not the R1?

A. The R1 is a conglomeration of a different set of rules and numbers that are used to prepare this statement and they [890] don't have to abide by segment reporting, okay? That doesn't mean that management doesn't use these numbers in any way. If you go to the 10K, the CSX Corporation where

we show the rail segment, there are very specific rules for all public companies on how you show and define each segment that you have within your business. So the R1 is a very industry specific document comparing data from all different railroads. I'm not comfortable saying management doesn't rely on information on how the business is doing in the R1.

Q. But let me review your testimony from just a short time earlier. It is your testimony that the operating income number that is shown on the CSX Corp.'s annual report for the rail segment would represent management's view of how you measure the operating performance of the rail segment, correct?

A. That's correct.

Q. So if that number is different from what is shown on the R1, the R1 does not reflect management's view of how you measure the operating performance of the rail segment?

A. And I'm not comfortable connecting those two dots. This is a totally different document. It is a legal entity, CSX Transportation. It is a different set of requirements and rules that are needed. So I'm not saying that the company doesn't rely on information in this report on how the company is operating.

Q. And that's not—that is not my question as to whether [891] the company relies on the R1 numbers in some fashion or not. But it is your testimony that the numbers—the operating income numbers shown on the annual report for CSX Corporation's rail segment reflect management's view of how you measure the operating performance of the rail segment, correct?

A. Yes.

Q. But you are not comfortable in saying that if the R1 numbers are different from that, that the R1 does not reflect management's view of how you measure the operating performance?

A. No. Why don't you ask me the question again. I'm getting confused by your questions.

Q. The annual report showing the operating results of CSX rail segment, the operating number that is shown on the annual report for the rail segment is reflective of management's view of how you measure the operating performance of the rail segment, correct?

A. That's right.

Q. Okay. If that number, if the net railway operating expense, net railway from railroad, sorry, if the net revenue from railway operations on the R1 report is different from what the annual report shows for the rail segment, then the R1 report does not reflect management's view of the operating performance of the rail segment.

A. The R1 report is not the rail segment, so it's totally different documents.

[892] Q. So you can't evaluate the operating performance of the rail segment based on the R1 report?

A. Not of the rail segment. This is just CSX Transportation, which is specifically the railroad.

Q. Whereas the rail segment on the annual report would represent all the rail transportation that are owned or used in providing rail freight service by CSX Corp.?

A. That's correct. It's a different—legal entities that add together to get to the rail segment.

Q. Ms. Sizemore, I have handed you what's been marked as joint exhibit 5. And can you identify that document?

A. It is the financial supplement for CSX Corporation in 2001.

Q. If you will turn to page 3 of that document. I'm sorry, that is the wrong page. It's not page 3. Now, that is page 3 of the document I have just handed you.

A. Yes.

Q. And, I'm sorry, did you identify that document?

A. Yes, I did.

Q. And that's the financial supplement to the 2001 annual report, correct?

A. That's right.

Q. Now, this document also reflects a segment reporting, doesn't it?

A. This is not governed by the SEC rules. It's additional

* * * *

[1037] percent terminal growth rate and change it to 3.7 percent growth rate, that's going to drive—that's going to come up with a lower terminal value than the one you chose up there, correct?

A. That's correct.

Q. And if you took the lower of the four terminal values so calculated, you would choose the one with the 3.7 percent terminal growth rate, correct?

A. Yes.

Q. If you did that, would that give CSXT a benefit in setting their value that none of the other unit value companies got?

A. I would say so.

MR. CALVERT: That's all, Your Honor.

MR. MCBRIDE: We have nothing, Your Honor.

THE COURT: Let me make sure of something.

MR. MCBRIDE: We move in 66, please,

MR. GOODWIN: Your Honor, I have already given it to Ms. Martin.

THE COURT: It is in. Let me ask, let me make sure. On the valuation work sheet, exhibit 32, page 1, up at the top, how did you choose the 8.2 billion as your proposed unit valuation of CSXT?

THE WITNESS: It's hard to back track as to how I did it. But basically, I had the range of the multiples from the [1038] multiple study. I could pick, as a for instance, the lowest indicated multiple of revenues. I could pick the lowest indicated multiple of E-B-I-T-D-A. Those numbers are not on

this sheet. But that helped me set what I thought was the lowest reasonable estimate of fair market value. It helped that I could construct a discounted cash flow analysis that came out with a similar number. If I hadn't been able to come up with a discounted cash flow, making conservative estimates that was at the bottom of the ranges of these market multiples, it could have been high, the point there, the lower limit would have been higher. But basically it's my belief that the market multiples, if you go to the extremes of either end, that those set the range and you can't go out of that range.

THE COURT: What weight did you give the discounted cash flow approach?

THE WITNESS: I don't do weighting [sic]. Again, the true value to me of the discounted cash flow is to help you narrow the range, or to arrive at a point estimate. When sort of your target is setting this range so that you can choose a lower limit to it, I think you are more relying on the market multiple approaches.

THE COURT: All right. So we are talking about the market multiple approaches. Where are the calculations to give me the range?

THE WITNESS: I think it's, depending on the order, it [1039] could be the third page where it says—it's half a page of printing, Comparable Publicly Traded Company Analysis.

THE COURT: And that's going to give me the range?

THE WITNESS: No, that is going to give you the point estimate for each of those, applying each of my point estimate of each of the multiples. As far as the range of all, as a for instance, the range of all the revenue multiples from the study, you would go to the next to the last page that's captioned Market Multiples at the top.

THE COURT: All right.

THE WITNESS: And, again, as a for instance, you could

look at revenues, and for these six railroads, sort of an absolute starting range would be the lowest of 1.66 to a high of 3.25. I mean, it depends on how much you want to refine the range, but that's a starting point as being sort of the absolute. Well, I don't want to say the word, absolute, because if there was something unusual about the company you are appraising, you could go outside of that range.

THE COURT: All right. And there is no weight to your various approaches, you are just comparing them?

THE WITNESS: I think that's true.

THE COURT: To come up with the 11.

THE WITNESS: I mean, it's really looking at all of them. It's really looking at all of them. But, again, your answer has to make sense in terms of all the approaches. I [1040] think I mentioned the—what I consider to be the most—one of the most important sheets in there is the sanity check at the end, where whatever number you picked, you would calculate what multiple did that indicate, or what percentage of the whole stock and debt that was. An appraisal has to make sense.

THE COURT: Any other questions for this witness?

MR. CALVERT: No, Your Honor.

MR. MCBRIDE: No, Your Honor.

THE COURT: All right. He can step down. Call your next witness. No, we are going to stop. All right. 9:15? See you in the morning.

(Trial recessed for the day)

UNITED STATES DISTRICT COURT
N.D. GEORGIA
ATLANTA DIVISION

Civil Action No. 1:02-CV-2634-CAP

CSX TRANSPORTATION, INC.,
Plaintiff,

v.

The STATE BOARD OF EQUALIZATION of the State of Georgia; BART L. GRAHAM, Commissioner of Revenue of the State of Georgia; RUSSELL W. HINTON, State Auditor of the State of Georgia; and RAY J. CRAWFORD, Director of the Georgia State Properties Commission,
Defendants.

Sept. 29, 2005

ORDER

PANNELL, *District Judge.*

The plaintiff, CSX Transportation, Inc. ("CSXT") filed this suit under Section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub.L. 94-210, 90 Stat. 54 (Feb. 5, 1976), which is now codified at 49 U.S.C. § 11501 (the "4-R Act"). The 4-R Act confers concurrent jurisdiction on federal district courts to enforce its provisions, so long as "the ratio of assessed value to true market value of rail transportation property exceeds by at least 5 percent the ratio of assessed value to true market value of other commercial and industrial property in the same assessment jurisdiction." *Id.* § 11501(c). Such jurisdiction lies notwithstanding the Tax Injunction Act of 1937, 28 U.S.C. § 1341, which ordinarily

prohibits district courts from enjoining, suspending or restraining the assessment, levy or collection of taxes under state law where the party may have a plain, speedy, and efficient remedy in state court. *Id.; Southern Railway Co. v. State Board of Equalization*, 715 F.2d 522, 526 (11th Cir.1983).

For the 2002 tax year, the Department of Revenue of the State of Georgia (the "Department") determined that the unit value of CSXT's rail transportation property was $8.2 billion and that the fair market value of CSXT's taxable railroad operating property in Georgia was $514,862,671 (the "Proposed Valuation"). The Department presented that value to the State Board of Equalization for the State of Georgia (the "Board") for approval. The Board approved the Proposed Valuation and issued a Notice of Proposed Assessment dated November 25, 2002.

CSXT makes three claims under the 4-R Act based on the Department's Proposed Valuation. First, CSXT claims that the Proposed Valuation is excessive and discriminatory in that the Department assessed CSXT's rail transportation property for ad valorem tax purposes at a higher ratio of assessed value to true market value than the ratio applicable to other commercial and industrial property in Georgia in violation of 49 U.S.C. § 11501(b)(1). Specifically, CSXT claims that the true market value of its rail transportation property on a unitary basis for the 2002 tax year does not exceed $6 billion, and that the true market value of its taxable rail transportation in Georgia does not exceed $369,253,752. This valuation claim is based primarily on an appraisal done by Mr. Thomas Tegarden, whose credentials are impeccable.

Second, CSXT claims that it has been singled out for discriminatory tax treatment by the defendants for the tax year 2002 in violation of 49 U.S.C. § 11501(b)(4). In particular, CSXT claims the Department's assessment of other centrally-assessed property is not based on the fair market

value of those properties. CSXT also claims that it is the only major centrally-assessed taxpayer in Georgia that suffered a significant tax increase for the tax year 2002.

Third, CSXT contends that the defendants discriminated against it in violation of 49 U.S.C. § 11501(b)(4) because the Department's Proposed Valuation for the tax year 2002 improperly included its intangible property, while the intangible property of all other commercial and industrial taxpayers is excluded from taxation. CSXT argues that the Department's valuation methods improperly compound intangible value, and CSXT urges the court to order the Department to use a yield capitalization approach, which CSXT claims will minimize the inclusion of intangible assets in the Department's valuation.

The matter was tried by the court sitting without a jury from May 16, 2005, through May 25, 2005. The court took the case under advisement pending the filing of post-trial briefs. The following order constitutes the court's findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52.

Factual Background

I. *The Parties*

A. *CSXT*

CSXT, the taxpayer in this case, is a Class 1 interstate common carrier by rail that operates in more than 71 counties in Georgia. It is subject to the jurisdiction of the Surface Transportation Board ("STB").

CSXT is a wholly-owned subsidiary of CSX Corporation. CSX Corporation's stock is publicly traded. As of January 1, 2002, CSX Corporation also owned several other subsidiaries including: (1) CSX World Terminals; (2) CSX Intermodal,

Inc.;[1] (3) CSX Lines; (4) CSX Technology, Inc.; and (5) CSX Hotels, Inc.

As of the fiscal year ending December 28, 2001, CSXT accounted for 75% of CSX Corporation's total operating revenues and 78% of its operating income.[2] CSXT's operating revenues for that year alone amounted to $6.082 billion with an adjusted operating income of $803 million.

By the mid-1990's only three Class 1 railroads existed and competed for freight traffic in the eastern half of the United States: (1) Consolidated Rail Corporation ("Conrail"), (2) Norfolk Southern Corporation ("Norfolk Southern"), and (3) CSXT. In August 1998, the STB approved the joint acquisition of Conrail by Norfolk Southern and CSX Corporation. The acquisition included an outright buyout of Conrail's assets by Norfolk Southern and CSX Corporation for approximately $10.5 billion and the assumption of net debt of $1.9 billion.

In June 1999, CSXT began operating portions of Conrail's system. By January 1, 2002, CSXT was operating approximately 42% of the former Conrail system. At that time, CSXT provided rail freight transportation over a network of approximately 40,000 miles of track and 23,000 route miles.[3] CSXT's network included a route through the southeastern United States, including Georgia, as well as a route from the New York/New Jersey area down the east coast to Florida.

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[1] CSX Intermodal ("CSXI") moves trailers or containers on flat cars to trucks. In addition, CSXI operates 33 terminals across the United States. When CSXI moves intermodal traffic over CSXT's system, CSXI pays CSXT a "transfer price" of approximately $350 to $400 million annually for CSXI's use of CSXT's resources and routes.

[2] Operating income is operating revenues minus total operating expenses.

[3] The acquisition of Conrail added 4,400 miles of track to CSXT's rail system in the Northeast United States and Canada.

CSXT's rail transportation property consists of a variety of items, including land, rail, track material, stations, and equipment. CSXT also operates rolling stock and equipment that it leases. During the time period in question, CSXT had between 34,000 and 36,000 employees and operated between 230,000 to 240,000 freight cars on its system.

Maintaining a rail transportation system requires heavy investment in capital expenditures.[4] Mr. Lewis, a Vice President of CSXT, testified that for the calendar years 2000 and 2001, CSXT's total capital expenditures were between $800 and $900 million.

The acquisition of Conrail had a noticeable effect on CSXT's revenues. For example, in 1997, CSXT's unlevered free cash flow was $467 million. In 1998, after the STB approved the Conrail merger, CSXT's unlevered free cash flow plummeted to negative $115 million. In 1999, CSXT' s [sic] unlevered free cash flow again plunged to negative $309 million. By 2000-2001, some efficiencies were beginning to be realized, and CSXT's unlevered free cash flow rose by 154.9% in two years.[5]

Similarly, the Conrail merger also had an effect on CSXT's operating ratio.[6] CSXT's operating ratio prior to the acquisition of Conrail was 75.4%. After acquiring Conrail, CSXT's operating ratio rose to a high of 89.9% and then began to decline again (to a more profitable ratio) in 2001.

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[4] The term "capital expenditure" refers to purchases of depreciable assets with long lives.

[5] In 2001 and 2002, CSXT Surface Transportation had a positive cash flow of around $150 million. Mr. Lewis testified that the positive cash flow was primarily due to real estate sales of $325 million.

[6] The term operating ratio refers to the ratio of operating expenses to revenue.

Although the acquisition of Conrail had a negative effect on CSXT's financial success in the short-run, the evidence at trial showed that it was likely that some efficiencies would be achieved in the future due to the merger. In fact, even CSXT's own expert, Mr. Tegarden, testified that some costs may be eliminated, which would increase future net operating income.

The evidence at trial also showed that railroads face considerable competition from other modes of transportation, such as trucks. Unlike trucks, however, railroads have to pay for and maintain their own infrastructure. Beginning in 1980, this competition steadily forced rates down. Taking trucks off the highways was the stated goal of the Conrail merger. To that end, the Conrail merger created a huge growth opportunity for CSXT. For instance, in 2001, CSXT was able to move 350,000 truckloads of merchandise off the roads and onto their rails.

B. *The Defendants*

The defendants are the Board and its individual members, including Bart L. Graham, the State Commissioner of Revenue.

The appraised and assessed values of most property in Georgia are determined by county boards of assessors. The parties refer to this property as "locally-assessed" property. Pursuant to O.C.G.A. § 48-5-6, most locally-assessed property subject to taxation in Georgia is to be appraised for assessment purposes at its fair market value. After any such nonexempt locally-assessed property in Georgia is appraised at its fair market value, an assessment ratio of 40% is applied to the appraised value to derive the assessed value. It is this assessed value against which property tax is levied and collected.

Companies classified in Georgia as "public utilities" are commonly referred to as "centrally-assessed" taxpayers. Centrally-assessed taxpayers include railroads, investor-owned electric utilities, investor-owned telephone companies, pipeline companies, and gas distribution companies. The State Revenue Commissioner issues proposed assessments of the operating and non-operating property of public utilities such as CSXT.

The Property Tax Division of the Department annually prepares a proposed assessment of CSXT's railroad transportation operating property for every Georgia county in which CSXT's taxable property is located.

II. *The Department's Proposed Valuation of CSXT*

In Georgia, the procedure for assessing rail transportation property is set forth in O.C.G.A. § 48-2-18. Under that statute, the Board approves an initial, proposed assessment of the taxpayer's property, and certifies that assessment to the counties in which the taxpayer owns taxable property. *Id.* § 48-2-18(c). *See also Telecom USA, Inc. v. Collins*, 260 Ga. 362, 364-65, 393 S.E.2d 235, 238 (1990) (discussing revised Georgia tax assessment procedures); *Colonial Pipeline Co. v. Collins*, 921 F.2d 1237 (11th Cir.1991) (same). Each county must then issue its final assessment to the taxpayer within 30 days; in doing so, "a county may, but is not required to, use the[ ] figures [provided by the Board] as the county's own tax assessment." *Colonial Pipeline*, 921 F.2d at 1240-41.

The Department used the unit rule method to value CSXT's railroad transportation operating property for 2002 ad valorem tax purposes. The unit rule method values the entire operating system of CSXT as a going concern and integrated whole irregardless of where it is located and without functional or geographic division of the whole into its component parts. A unit value determined pursuant to the unit rule method is meant to capture all of the operating assets

of the company whether owned or used. The parties agree that the unit rule method is appropriate under Georgia law.

Gregg Dickerson is the Program Manager in the Public Utilities Section of the Local Government Services Division of the Department. Mr. Dickerson first joined the Department in 1983 and spent ten years doing valuations pursuant to the unit rule method for centrally-assessed public utilities, including railroads. In 1993, he left the Department and went to work for Norfolk Southern railroad as a property tax manager, where his duties included reviewing and negotiating unit values with various states.

In the fall of 2001, Mr. Dickerson was approached by the then-director of the Department, Mr. Larry Griggers, who asked him to return to the Department. Mr. Griggers stated that he was concerned that the public utility digest for Georgia had decreased from 10% to 5% of the total state property tax digest since Mr. Dickerson's departure. Mr. Dickerson agreed to return, but stated that he would not come back for the purpose of "raising the numbers." He would only come back if Mr. Griggers' purpose was to "get[ ] the numbers right." Mr. Griggers agreed and Mr. Dickerson returned to work for the Department in September 2001. Mr. Dickerson was the individual responsible for preparing the valuation worksheets that served as the basis for the Department's Proposed Valuation of CSXT for the tax year 2002.

Applying the unit rule method, Mr. Dickerson first prepared a Railroad Valuation Worksheet. The Railroad Valuation Worksheet calculated CSXT's unit value using three valuation methods: (1) a stock and debt approach, (2) a discounted cash flow ("DCF") approach, and (3) a market

multiple approach. These different approaches yielded the following values:

Stock and Debt	$12.022 billion
DCF	$8.126 billion
Market Multiples[7]	$12.346 billion
	$10.769 billion
	$8.474 billion

After coming up with this range of values for CSXT, Mr. Dickerson selected $8.2 billion as the lower limit of what the going concern unit value of CSXT could reasonably be. He then used $8.2 billion as the foundation for the Department's Proposed Valuation.

After determining the unit value for CSXT, Mr. Dickerson then estimated a working capital adjustment of $400 million and deducted that from his unit value estimate of $8.2 billion to eliminate the effect of certain intangible assets. Next, Mr. Dickerson allocated the adjusted unit value estimate of $7.8 billion to the state of Georgia by using the percentage of Georgia road miles to system road miles. For the tax year 2002, the percentage so applied equaled 7.194059%, resulting in an allocated value of $561,136,602 for the state of Georgia.

To arrive at CSXT's proposed taxable fair market value in Georgia, Mr. Dickerson then deducted amounts for motor vehicles, exempt pollution control equipment, and exempt railroad lines. As a result, Mr. Dickerson determined that CSXT's taxable fair market value in Georgia for the tax year 2002 was $514,862,671 and presented this number to the Board.

Following the Board's approval, the Department issued a Notice of Proposed Assessment dated November 25, 2002

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[7] The market multiple approach yielded three different values because the Department calculated three different "multiples."

(the "Proposed Assessment"), to CSXT and to the counties in which CSXT had taxable property. The Proposed Assessment included three components: (1) the portion of the Department's proposed taxable fair market value of CSXT's operating property in Georgia attributable to each county, (2) the level of assessment that the Board determined each county should use, and (3) a proposed assessment for each Georgia county in which CSXT had taxable property, which was derived by multiplying the county's distributed value by 40% or the prevailing level of assessment in that county.

After this litigation commenced, in November 2003, Mr. Dickerson prepared a complete appraisal of CSXT using essentially the same three valuation methods that he employed with the Proposed Valuation. The purpose of this appraisal was to provide the court with Mr. Dickerson's point estimate of CSXT's unit value, rather than a figure at the lower end of his range of fair market values.

Following the close of fact discovery in this case, Mr. Dickerson prepared a revised full appraisal of CSXT in support of the Proposed Valuation. The only difference between Mr. Dickerson's November 2003 appraisal and the revised appraisal involved a change in the calculation of the cost of equity used in deriving the weighted cost of capital. The range of values Mr. Dickerson arrived at in his second appraisal were:

Stock and Debt	$12.128 billion
DCF	$10.960 billion
Market Multiples	$12.434 billion
	$10.871 billion
	$8.986 billion

Based on this range of values, Mr. Dickerson opined that the fair market system value of CSXT as of January 1, 2002, prior to adjustments for leases was $11 billion. Mr. Dic-

kerson then added $807 million to this value to account for the value of CSXT's operating leases. He ultimately opined that the fair market unit value of CSXT was $11.807 billion.

III. *An Overview of the Parties' Valuation Approaches*

As noted above, in Georgia, as in most states, a railroad's operating property is valued for property tax purposes as a unit. Under the unit concept of value, the fair market value of the railroad is measured by appraising the whole property as a going concern. To determine the unit value of a company, the appraiser must first choose from and apply a variety of valuation methods.

There are three general approaches to valuing a company or property: (1) the sales comparison approach, (2) the income approach, and (3) the cost approach. The standard sales comparison approach determines the value of a property or company by examining and comparing actual sales of comparable properties or companies. Conversely, the cost approach determines the value of a property by totaling the original costs of the various components of the property, and then making adjustments to account for depreciation or obsolescence. The theory behind the income approach is that anyone who buys a company buys it only for the income the company will generate.

Mr. Dickerson's responsibilities in preparing proposed assessments for centrally-assessed property for the tax year 2002 included reviewing the valuation methods that had been used by the Department in the past. As a result of his analysis, Mr. Dickerson made certain changes to the valuation methods used for all centrally-assessed taxpayers subject to the unit rule method. Those changes, which were applied on an across-the-board basis, included replacing the existing capitalized earnings approach with a DCF model. He also

replaced what had been labeled as a direct capitalization approach with a market multiple approach.

For CSXT, Mr. Dickerson used three different valuation methods: (1) a stock and debt approach, (2) a DCF approach, and (3) a market multiple approach. In rough terms, the stock and debt method is a surrogate for the sales comparison approach. It assumes that the value of a company equals all of the outstanding debt owned by that company plus the company's equity. Similarly, the market multiple approach is also a substitute for the sales comparison approach. Under a market multiple approach, the appraiser derives market multiples from the stock prices of companies that are engaged in similar lines of business and compares those multiples with the subject company to determine the value of that company.

Unlike the stock and debt and market multiple approaches, the DCF approach is a version of the income approach. Under the DCF approach, the appraiser makes assumptions to project cash flows for the company for a designated number of years after the assessment date, and then discounts those expected cash flows to their present value. The appraiser then calculates a terminal or reversion value representing the value of the company at the end of the projection period. The total of the discounted cash flows during the projection period and the terminal value gives the appraiser his unit value for the company.

CSXT's valuation expert, Mr. Tegarden, also used three valuation methods to value CSXT: (1) a stock and debt approach, (2) a cost approach, and (3) a yield capitalization approach. The yield capitalization approach is another variation of the income approach. It can perhaps be described

as a cousin of the Department's DCF approach. For example, the Department's DCF model is expressed as:

$$V = \frac{(CF1)}{(1+k)} + \ldots \frac{(CFn)}{(1+k)} + \frac{T}{(1+k)}$$

Cfn = net cash flow for the year n, k = discount rate, T = terminal value, and n = year. Mr. Tegarden's yield capitalization approach is expressed by the formula:

$$V = \frac{I}{r}$$

I = income and r = discount rate.

Mr. Tegarden gave no weight to his stock and debt value, very little weight to his calculations under the cost approach, and primary weight to his yield capitalization value. Using this weighted scale, Mr. Tegarden picked approximately $6 billion as the unit value of CSXT.

Legal Analysis

I. *The 4-R Act*

The 4-R Act prohibits a state from "[a] ssess[ing] [sic] rail transportation property at a value that has a higher ratio to [its] true market value . . . than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to [its] true market value. . . ." 49 U.S.C. § 11501(b)(1). The 4-R Act also prohibits states from levying or collecting taxes based on such an assessment, or otherwise discriminating against rail carriers in taxation. *Id.* § 11501(b)(2)-(4). "Assessment" is defined in the 4-R Act as "valuation for a property tax levied by a taxing district." *Id.* § 11501(a)(1).

II. *Burden of Proof*

The burden of proof in a case brought under the 4-R Act is determined by state law. 49 U.S.C. § 11501(c). The 4-R Act

requires a district court to use the burden of proof generally applicable to civil proceedings. *See Burlington Northern Railroad Co. v. Bair*, 766 F.2d 1222, 1226 (8th Cir.1985); *Atchison, Topeka, and Santa Fe Railway v. Lennen*, 732 F.2d 1495, 1500 (10th Cir.1984). In Georgia, a preponderance of the evidence is "the essential quantum of evidence . . . necessary to satisfy the minds of the fact finders in civil cases." *Ocean Accident & Guarantee Corp. v. Bates*, 104 Ga.App. 621, 622, 122 S.E.2d 305, 307 (1961). Thus, CSXT' s [sic] burden is the preponderance of the evidence standard.[8]

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[8] The defendants contend that the court must accept their tax assessment as prima facie correct, and that the burden is on CSXT to show that their assessment is in error. The defendants' argument is based on their belief that the burden of proof applicable in this case is the same burden of proof used when a taxpayer litigates the assessment they received in Georgia. This is not, however, a case where CSXT is simply appealing the Department's assessment. This is a case brought under the 4-R Act and the court must determine the true market value of CSXT. CSXT, in turn, has the burden of proving by a preponderance of the evidence that the true market value of its property is $6 billion. To do this, CSXT presented two types of evidence. First, it criticized the Department's calculations. Second, it presented a valuation of its property by Mr. Tegarden. In a more typical case, the court would look at both Mr. Tegarden's appraisal and the Department's appraisal to determine the true market value of CSXT. If the court found by a preponderance of the evidence that CSXT's true market value was $6 billion, as proposed by CSXT, then the court would compare the Department's Proposed Valuation to CSXT's true market value to determine if discrimination occurred. However, as explained later in this order, the court cannot consider Mr. Tegarden's valuation because it was prepared using different valuation methods than the Department. The court, therefore, is limited to looking solely at CSXT's criticisms of the Department's valuation.

III. *Whether the Department Assessed CSXT's Operating Property in Georgia for the Tax Year 2002 in Excess of its True Market Value, Resulting in a Ratio of Assessed Value to True Market Value for CSXT's Property which Exceeds by More than 5% the Ratio of Assessed Value to True Market Value of Other Commercial and Industrial Property in Georgia*

A. *May CSXT Challenge the Department's Chosen Valuation Methods?*

In this case, the parties disagree over the proper way to calculate the value of CSXT under each valuation method. Significantly, the parties also disagree over which valuation method the Department should use to value CSXT.

One of the problems with subjecting complex issues like valuation to judicial determination is that the court generally must choose among the competing claims of experts. Unless the court performs its own appraisal, the court must rely either on CSXT's experts or the Department's experts. The court, of course, may adjust an expert's appraisal up or down based on other experts' critiques of the appraisal, but the starting point for judicial determination is always one appraisal or another, and each appraisal is based on a particular methodology that, to a large extent, predetermines the result. Thus, implicit in the court's holding is a decision as to the proper valuation method.

The evidence shows that all five approaches used by CSXT and the Department, the yield capitalization, DCF, stock and debt, market multiple, and cost approaches, are widely used to value property. The question, then, is whether the Department is free to choose among accepted valuation methods or whether the 4-R Act compels the use of one particular method.

The United States Supreme Court in *Burlington Northern Railroad Co. v. Oklahoma Tax Commission*, 481 U.S. 454,

463 n. 5, 107 S.Ct. 1855, 1861 n. 5, 95 L.Ed.2d 404 (1987), expressly left open the question of "whether a railroad may, in an action under [the 4-R Act], challenge the appropriateness of the accounting methods by which the state has determined the railroad's value, or is instead restricted to challenging the factual determinations to which the state's preferred accounting methods were applied." *Id.*

Since the *Burlington Northern* decision, several courts have answered this question. Perhaps the most followed decision is the Fourth Circuit's decision in *Chesapeake Western Railway v. Forst*, 938 F.2d 528, 533 (4th Cir.1991), *cert. denied*, 503 U.S. 966, 112 S.Ct. 1577, 118 L.Ed.2d 220 (1992). *See also Burlington Northern Railroad Co. v. Bair*, 815 F.Supp. 1223, 1228-29 (S.D.Iowa 1993) (following *Chesapeake* and holding that a railroad may not challenge the state's chosen methodology); *cf. Union Pacific Railroad Co. v. State Tax Commission of Utah*, 716 F.Supp. 543, 556-57 (D.Utah 1988) (holding that as long as the state's method has a rational basis and was not chosen for a discriminatory purpose, the court will not disturb the state's choice). In *Chesapeake*, the railroad brought an action challenging Virginia's "over the fence" method of valuing railroad property and arguing for use of the unit method. *Chesapeake*, 938 F.2d at 530. Relying primarily on the 4-R Act's legislative history, the Fourth Circuit concluded that the 4-R Act "does not provide a basis for railroads to challenge a state's preferred methodology for ascertaining the true market value of railroad property." *Id.* at 533; *see also Richmond, Fredericksburg & Potomac Co. v. Forst*, 4 F.3d 244, 250 (4th Cir.1993) ("[A] railroad may present independent evidence of the fair market value of its property, provided, of course, that it limits its evidence to factors that may properly be taken into account under the state's chosen methodology.").

As support for its argument that the court should allow it to challenge the Department's valuation methods, CSXT cites to

decisions from the Second and Ninth Circuit. Neither of these circuits, however, allowed a railroad to freely challenge the state's methodology. For instance, in *Consolidated Rail Corp. v. Town of Hyde Park*, 47 F.3d 473, 482 (2d Cir.1995), the Second Circuit held that the state must apply the "same valuation standard and methods to the railroad property as are used on the commercial and industrial properties to which [the railroad] is compared." The implicit holding in *Hyde Park*, therefore, is that a railroad cannot challenge the state's valuation methods as long as the state uses the same methods for other commercial taxpayers. Here, the evidence at trial showed that the Department used essentially the same valuation methods for CSXT that it used for other centrally-assessed taxpayers.

Similarly, while the Ninth Circuit allowed a railroad to challenge the state's chosen methodology, it also held that the state's chosen methodology is presumed correct and can be defeated only by clear, cogent, and convincing evidence. *Burlington Northern Railroad v. Department of Revenue of the State of Washington*, 23 F.3d 239, 241 (9th Cir.1994).

Although the Eleventh Circuit has yet to address this question, the court finds that the legislative history, which is admittedly rather thin, supports the Fourth Circuit's determination that the 4-R Act does not confer jurisdiction upon this court to order the Department to use a specific accounting method to determine the value of CSXT. The committee report on Senate Bill 927, one of several precursors to the 4-R Act, states that:

> [The bill] does not suggest or require a State to change its assessment standards, assessment practices, or the assessments themselves. It merely provides a single standard against which all affected assessments must be measured in order to determine their relationship to each other. It is not a standard for determining value; it is a

> standard to which values that have already been determined must be compared.

S.Rep. No. 1483, 90th Cong., 2d Sess.App. B (1968).

Similarly, in hearings on House Bill 16245, another forerunner of the 4-R Act, Mr. Lanier, a railroad representative, testified that, "[t]he standards and methods of valuation that any state wishes to use would be totally unaffected by this legislation." *Chesapeake*, 938 F.2d at 531 (*citing* Hearing Before the Subcommittee on Interstate and Foreign Commerce on H.R. 16245, 91st Cong., 1st Sess. 138 (1970)). Thus, the legislative history suggests that the statute was not meant to require a state to use a particular accounting method, at least as long as the state's chosen methods are rational and were not chosen for a discriminatory purpose.

After eight days of trial, it is apparent to the court that valuation is an art, not a science. Valuing a business requires an appraiser to make "judgment calls," even under CSXT's yield capitalization method. Absent a willing buyer and a willing seller, the determination of true market value for purposes of ad valorem taxation is always an estimate, always an expression of judgment, and always a result built on "judgment calls." The appraisals in this case are good examples of this. Mr. Tegarden and Mr. Dickerson each used at least three different valuation methods to arrive at the market value of CSXT. Both Mr. Tegarden and Mr. Dickerson arrived at different conclusions as to the value of CSXT under each method that they utilized. For example, CSXT's own expert, Mr. Tegarden, arrived at the following three values for CSXT for the tax year 2002:

Cost Approach	$6.150 billion
Income Approach	$5.983 billion
Stock and Debt Approach	$9.637 billion

The $3 billion difference in Mr. Tegarden' s values makes clear that the determination of the true market value of CSXT in this case is, at best, an educated guess. The fact that the determination of CSXT's true market value is an educated guess weighs against the court requiring the Department to use a particular valuation method.

In addition to the fact that all appraisals are at best educated guesses, the court is unwilling to dictate a particular valuation method to the Department for other reasons. From the testimony of the Department's witnesses, the court concludes that the Department sincerely seeks to arrive at what it considers to be CSXT's true market value, and that, to that end, it constantly reevaluates its methods and changes them when the Department becomes convinced that they are erroneous. If this court were to conclude that the 4-R Act required the Department to adopt the yield capitalization method of valuation, it would prevent the Department from critically examining its appraisal methods and would discourage it from adopting new and better methods as they become accepted by the appraisal profession.

For all of these reasons, the court concludes that the 4-R Act does not generally allow a railroad to challenge the state's chosen methodology. As long as the Department's chosen valuation methods are rational and were not chosen for the purpose of discriminating against CSXT, the court will not second guess the Department's choice of methods.

Even if the court were forced to choose between competing valuation methods, the court finds that the Department's chosen methods have much to commend them. Not only does the Department consistently use essentially the same approach for all centrally-assessed property, but its valuation methods are based on historical and market data readily available to investors and to the defendants. All three of the Department's valuation methods are widely accepted and used by valuation experts. The fact that these methods are

widely used and accepted is evidenced not only by the testimony of the majority of experts, but also by the fact that they have been approved by other courts. *See, e.g., Bair*, 815 F.Supp. at 1228-29 (approving of the use of the stock and debt approach to valuing the BN railroad); *Burlington Northern Railroad Co. v. Department of Revenue of the State of Washington*, No. C90-5417, 1992 WL 201947, at *4-5 (W.D.Wash. Aug.13, 1992), *aff'd* 23 F.3d 239 (9th Cir.1994) (giving deference to the state's use of the stock and debt, DCF, and cost approaches).

(1) *Whether the Department's Chosen Valuation Methods Are Irrational*

The court finds that the Department's chosen valuation methods are rational. As noted above, the stock and debt approach, market multiple approach, and DCF approach have much to commend them. They are widely accepted and generally based on historic and market data readily available to the public and investors.

CSXT' s [sic] primary criticism of the Department's valuation methods is that they compound intangible values at a higher rate than CSXT's yield capitalization method does. For example, CSXT introduced testimony showing that stock prices include value attributable to intangible property. Because all three of the Department's valuation methods utilize stock prices derived from CSX Corporation, CSXT's parent company, CSXT argues that the Department's approaches are flawed.

The court agrees that stock prices include intangible value, whether it is "intangible influences" or "intangible property." By extension, therefore, any approach that utilizes stock prices includes some intangible value. Nevertheless, the fact that the Department's approaches include intangible value does not make their use irrational. Both parties' experts agree that the fair market value of a business is meant to

value what a willing buyer would pay for that business. Stock prices, thus, are particularly relevant for appraisal purposes because absent a recent sale of the business, the company's stock price is the only real example of what a willing buyer would pay for a share of that business.

The court also points out that CSXT's own valuation methods are not exempt from the same criticism. It is undisputed that CSXT's yield capitalization method relies to some extent on stock prices and includes at least some value attributable to intangible property.

(2) *Whether the Department's Chosen Valuation Methods Were Adopted for a Discriminatory Purpose*

The court also finds that the evidence at trial does not support the conclusion that the Department selected the DCF approach, the stock and debt approach, or the market multiple approach for the purpose of discriminating against CSXT. The evidence at trial showed that the Department utilizes essentially these same methods when valuing non-railroad centrally-assessed property.

Accordingly, the court concludes that CSXT cannot challenge the Department's chosen valuation methods in this case. This ruling, of course, does not prevent CSXT from challenging the manner in which the Department calculated the value of CSXT using its stock and debt, DCF, and market multiple approaches.

B. *Can the Court Consider Mr. Tegarden's Appraisal of CSXT?*

The court is required to weigh the evidence and make its own factual findings regarding the true market value of CSXT. The question then arises as to whether the court can consider evidence of the true market value of CSXT' s [sic] operating property determined by a valuation method not employed by the Department. The court finds that it cannot

do so in this case because the valuation methods chosen by the Department are rational and were not adopted for a discriminatory purpose.

The court must make its factual findings as to the value of CSXT using the methods utilized by the Department. Otherwise, the court will be, in effect, ordering the Department to use a different valuation method.

It is undisputed that the Department used a DCF approach, a stock and debt approach, and a market multiple approach to value CSXT. CSXT's expert, Mr. Tegarden, appraised CSXT using a yield capitalization approach, a stock and debt approach, and a cost approach. Mr. Tegarden testified that he placed no weight on his calculations under the stock and debt approach and little emphasis on his calculations under the cost approach. Therefore, the court concludes that Mr. Tegarden's appraisal is based primarily on the yield capitalization approach with some small emphasis on the cost approach.[9]

The court concludes that both the cost approach and the yield capitalization approach are different valuation methods than the Department's valuation methods. Although the yield capitalization approach is undoubtedly a cousin of the Department's DCF approach, the fact that it is truly a different valuation method is most aptly illustrated by the fact that CSXT spent much of its time at trial arguing that the court should order the Department to adopt the yield capitalization approach because the other methods used by the Department to value CSXT were flawed.

Because the yield capitalization and cost approaches are different valuation methods than the methods used by the

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[9] CSXT admits that the cost approach is not particularly reliable for use in valuing railroad assets because of the substantial obsolescence affecting railroad property. Pl.'s Post-Trial Br. at 22 [Doc. No. 113].

Department, the court cannot consider Mr. Tegarden's valuation of CSXT under these approaches. Since CSXT has introduced into evidence no other appraisal of its property using the valuation methods employed by the Department, the court must necessarily limit its analysis to the criticisms presented by CSXT as to the manner in which the Department calculated the value of CSXT under its DCF, stock and debt, and market multiple approaches.

C. *The Department's Appraisals*

Before the court reaches CSXT's criticisms of the Department's calculations, the court must first address the two appraisals created by the Department after the commencement of this litigation. As noted earlier, after this litigation commenced, the Department prepared two appraisals of CSXT. The purpose of these appraisals was to provide the court with Mr. Dickerson's point estimate of CSXT's unit value, rather than a figure at the lower end of his range of fair market values. The only difference between the two appraisals was a change in the calculation of the cost of equity used in deriving the weighted cost of capital.

The fact that the Department created two appraisals significantly complicates this case. The Department urges the court to disregard its original Proposed Valuation and hold that the actual fair market unit value of CSXT is $11.807 billion, which is the value derived from Mr. Dickerson' s [sic] revised appraisal. CSXT, however, focused the majority of its time at trial and in its post-trial briefs challenging the Department's Proposed Valuation.

The court has considered the Department's revised appraisal. As noted earlier, in its revised appraisal, the Department changed the way it calculated the cost of equity used in deriving the weighted cost of capital for CSXT. It appears to the court that the Department created this new method of calculating the cost of equity in late 2003 or early 2004 and,

thus, did not apply this formula to any other taxpayer in 2002. The court questions the relevancy of the revised appraisal for use in this lawsuit. The methods used were not applied to other taxpayers for the year 2002, and the revised appraisal was not used by the Department in assessing the values at issue here. The controversy before the court is the methods and the amounts used, not what could have been used. The court's analysis and approval (or disapproval) of the revised appraisal essentially amounts to an "advisory" opinion. Further, applying this new method of calculating the cost of equity to CSXT when it was not used for any other taxpayer would be inherently discriminatory. Accordingly, the court will focus the remainder of this order on the Department's Proposed Valuation.

D. *CSXT's Criticisms of the Department's Calculations*

As noted above, the Department utilized three methods for determining the fair market value of CSXT: (1) the stock and debt approach, (2) the DCF approach, and (3) the market multiple approach. Each of these approaches yielded a different unit value for CSXT. From this range of values, Mr. Dickerson then chose a number, $8.2 billion, that was closest to the lowest value in that range. The $8.2 billion unit value became the foundation for the Department's Proposed Valuation.

CSXT challenges the calculations made by Mr. Dickerson under his Proposed Valuation on four grounds. First, CSXT claims that the Department made errors in its DCF analysis. Second, CSXT claims that the Department calculated excessive stock and debt figures. Third, CSXT claims that the Department utilized excessive market multiple figures. Finally, CSXT claims that the Department improperly double-counted the value of CSXT's leased equipment.

(1) *CSXT's Criticisms of the Department's DCF Analysis*

To arrive at the DCF value of CSXT, the Department first calculated CSXT's anticipated future operating free cash flows for a ten-year period from 2002 to 2011 based on projections regarding the growth rate of CSXT's revenues, expenses, and capital expenditures. The Department then calculated a terminal value for CSXT (i.e., what a purchaser would expect to pay for the company at the end of the period). Next, the Department discounted this cash flow to January 1, 2002, using as the discount rate a 9.90% after-tax average weighted cost of capital. This calculation yielded a figure of $7,518,317,142, to which the Department added an amount for leased equipment of $607,976,209 to come up with a DCF value of CSXT of $8,126,293,350.

In particular, the Department's DCF model projected an increase in CSXT's cash flow of 69% from 2001 to 2002. The Department's model also projected a declining growth rate in cash flows from 5.32% in 2003 to 3.58% in 2011 and then assumed a constant terminal growth rate of 6.3% from 2011 into perpetuity. In addition, the Department assumed a 2% growth in revenues per year and projected that CSXT could achieve an 80% operating ratio by 2011.

According to CSXT, several of the assumptions in the Department's DCF model are erroneous because they allegedly have no basis in the historic record of CSXT's performance. In particular, CSXT claims that the Department erroneously projects: (1) a 69% increase in cash flow from 2001 to 2002, (2) a 6.3% terminal growth rate, and (3) an operating ratio of 80% by 2011. CSXT argues that these allegedly erroneous financial projections cause the Department's DCF model to overstate the value of CSXT.

(a) *The Department's Selection of 69% as the First Year's Cash Flow*

As noted above, the first year of the Department's DCF model assumes that CSXT's cash flow will increase by 69% over CSXT's actual cash flow for 2001. CSXT argues that this increase is bizarre and unsupported by the record. CSXT, however, introduced no evidence at trial as to what increase, if any, the Department should have projected or how that change would have affected the Department's value. In fact, instead of presenting testimony as to what the percentage increase or decrease the Department should have used and how changing that number affects the Department's DCF value for CSXT, CSXT argued that the court should correct the Department's projected terminal growth rate.

Regardless, the court finds that a 69% increase in projected cash flow from 2001 to 2002 is not bizarre. The evidence at trial showed that CSXT' s [sic] cash flow from 1991-2001 increased annually from 5.6% to 154.9% and sometimes declined. In fact, from 2000 to 2001, CSXT's unlevered free cash flow increased by more than 100%. Furthermore, as noted by CSXT' s [sic] expert at trial,[10] it is likely that some efficiencies may be achieved in the future due to the integration of CSXT and Conrail. These efficiencies will likely increase cash flow and reduce costs.

(b) *The Department's Selection of 6.3% as the Terminal Growth Rate*

CSXT next argues that the Department's decision to choose 6.3% as the terminal growth rate is excessively optimistic. CSXT points out that 6.3% is much higher than the growth rate that the Department projected for the years 2003-2011.

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[10] This statement was made by Mr. Tegarden in the context of explaining how he came up with $700 million as his estimate of CSXT's future net operating income.

CSXT also argues that the logical incongruence of the Department's terminal growth rate is indicated by the fact that the Department estimated that CSXT' s [sic] revenue would grow at only 2%. CSXT points out that if revenue grows at only 2%, while free cash flow (roughly revenue minus expenses) grows at 6.3% then at some point in time expenses would have to decline and become negative to sustain the 6.3% growth in free cash flow.

The court finds that the Department's decision to adopt a 6.3% terminal growth rate is not erroneous. First, to the extent that CSXT's experts opined that 6.3% was an unrealistic terminal growth rate, the court finds that their testimony was not credible. Second, the court notes that none of CSXT's experts testified as to what a proper terminal growth rate should be. At most, these experts suggested that the Department should have adopted 3.5% or 4.5% as the terminal growth rate. These "suggested" rates also suffer from some of the same infirmities that the rate selected by the Department does. For example, if revenues grow at 2%,[11] but free cash flow grows at any number higher than 2% (e.g., 3.5% or 4.5%) then eventually costs will have to decrease to a negative number.

(c) *The Department's Projected Operating Ratio*

CSXT also criticizes the operating ratio forecasted in the Department's Proposed Valuation. CSXT points out that it did not achieve its planned operating income or ratio from June 1999-December 2002. CSXT also presented evidence from Mr. Lewis, CSXT's Vice President of Finance, that the

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[11] Because the growth rate for revenue slowed to .4% per year from 1996 to 2001, CSXT also argues that the Department's projected growth rate of 2% per year for revenue is unduly optimistic. The court disagrees. CSXT admits that a 2% annual growth in revenue is not inconsistent with national trends for railroads between 1991 and 2001.

business risks facing the railroad industry make it "difficult to imagine . . . hav[ing] a lower operating ratio."

While it is true that CSXT did not achieve its planned operating ratios from 1999-2002, this fact alone does not indicate that the target operating ratios predicted by the Department were erroneous. Among other things, the Department estimated that CSXT would achieve an operating ratio of 80% by the year 2011. Eighty percent is consistent with CSXT' s [sic] strategic plan, its presentations to bond rating agencies, and the average historic operating ratios achieved by railroads, including CSXT, from 1995-2001. In fact, in 1998, prior to CSXT's acquisition of Conrail, CSXT achieved a 78.6% operating ratio. By 2001, CSXT's operating ratios had begun to decrease from a high of 89.9% in 2000. CSXT's 2001 Annual Report noted this change in trend stating, "With revenues expected to go up this year, the railroad's operating ratio, i.e., total costs as a percentage of total revenues, should improve considerably." Thus, it was reasonable for the Department to project that CSXT would achieve an operating ratio of 80% by the year 2011.

(2) *CSXT's Criticisms of the Department's Stock and Debt Analysis*

The Department determined the stock and debt value of CSXT by taking normalized year-end price data from Standard & Poor's Stock Guide and information from CSX Corporation's 2001 Annual Report. The Department concluded that the total market value of CSX Corporation's stock, its long-term debt, and the excess of current liabilities over current assets as of January 1, 2002, was $15,219,745,138. The Department next performed several calculations to determine what portion of this total was properly attributable to CSXT. The ratios the Department calculated were: 74. 91%, 81. 89%, 77. 93%, and 75. 47%. The Department selected 75% as a conservative number within that range. The Department then multiplied

$15,219,745,138 by 75% to come up with the portion of CSX Corporation's debt and equity which was allocable to CSXT. After adding $607 million for leased equipment, the Department arrived at $12,022,785,209 as the stock and debt value of CSXT.

In CSXT' s [sic] post-trial brief, CSXT points out a host of problems with the stock and debt approach generally, as opposed to problems with the Department's calculation of CSXT's stock and debt value. For example, CSXT argues that there is a disconnect between stock and debt values and the value of the taxable assets being valued in this case. CSXT points out that a company's stock price inevitably includes intangible values and assets not in existence on the date of the assessment, whereas an appraiser is only supposed to value tangible operating assets that are in existence as of the date of the appraisal.

As the court has previously indicated, it was proper for the Department to use the stock and debt approach to come up with a range of values for CSXT. *See Bair*, 815 F.Supp. at 1239 (approving of the use of the stock and debt approach in the appraisal of a railroad). The court, moreover, has already held that CSXT may not challenge the Department's chosen valuation methods.

In addition to criticisms of the stock and debt approach generally, CSXT argues that the stock and debt approach is not appropriate in this case because CSXT is not a publicly traded company. Although the stock of CSX Corporation is publicly traded and CSXT is wholly-owned by CSX Corporation, CSXT claims that it is difficult to identify a stock value attributable to CSXT' s [sic] railroad assets.

The court finds this argument unpersuasive. The mere fact that the Department must calculate and allocate a portion of CSX Corporation's stock to CSXT does not justify rejecting the Department's stock and debt value. Notably, CSXT does

not argue that the Department allocated the wrong proportion of CSX Corporation's equity to CSXT. In fact, it appears to the court that the parties agree that CSXT constitutes between 75-80% of CSX Corporation's total equity. CSXT's own expert, Mr. Tegarden, attributed 78.9% of CSX Corporation's total equity to CSXT when he calculated the discount rate in his yield capitalization approach.[12]

CSXT's final argument is that the Department erred by failing to make an adjustment to reflect the liquidity of stocks, as opposed to assets. CSXT points out that it is easier to buy a few units of stock, as opposed to the entire operating assets of a railroad. Because it is easier to buy stock, shares of stock reflect a liquidity premium that is not shared by the hard assets of a company.

Even if the court were to conclude that CSXT was correct, CSXT failed to present any expert testimony attesting as to how large an illiquidity discount the Department should have applied. At most, Mr. Tegarden' s [sic] report suggests that an illiquidity discount plus an adjustment for minority interests of 37.5% may be appropriate.[13] Pl.'s Ex. 1 at 60, n.

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[12] In other parts of its brief, CSXT suggests that the Department may have miscalculated the amount of debt attributable to CSXT. Even if the court were to accept this criticism, as well as CSXT's liquidity criticism described later in this opinion, according to the court's calculations the unit value of CSXT would be approximately $7.6 billion. This number is much higher than the $6 billion value proposed by CSXT.

Further, the court notes that the value of CSX Corporation's debt is $8.296 billion. If the court were to attribute 75% of CSX Corporation's debt to CSXT, the value of CSXT would be $6.2 billion. If, as CSXT claims, the value of CSXT was $6 billion, CSXT would have a negative equity value. CSX Corporation, however, held investment grade bond ratings implying a profitability level in excess of that needed to pay both current interest expenses and the principal balance of debt.

[13] If the court were to assume that CSXT's stock has a value in the market that is 37.5% higher than its underlying assets, according to the court's calculations the Department's stock and debt value of CSXT

46 ("Some studies have suggested that the effect of these two adjustments would be a reduction of the stock prices by approximately 37.5%."). This statement, however, is not specific to CSXT, nor does the court construe it as Mr. Tegarden's opinion regarding the actual illiquidity discount that should be applied to CSX Corporation's stock. In fact, Mr. Tegarden failed to include an illiquidity discount when arriving at his own stock and debt value.[14]

Nor is the court convinced that an illiquidity discount should be applied here. While stocks are undoubtedly more liquid than the entire operating assets of CSXT, buying the entire operating assets of a company gives the purchaser something that buying a few shares of stock cannot give him: control. One of CSXT's experts, Dr. Heaton, testified that an acquiring company will sometimes pay a control premium when the acquiring company believes that they can add value (create synergy) to the existing company. To the extent that any illiquidity discount may have been necessary, it may also have been completely offset by the necessity of adding a control premium.

(3) *CSXT's Criticisms of the Department's Market Multiple Analysis*

For the Department's market multiple approach, the Department identified six comparable railroads: (1) Burlington Northern, (2) Canadian National, (3) Canadian Pacific, (4) CSX Corporation, (5) Norfolk Southern, and (6) Union Pacific. The Department then multiplied the number of shares for these railroads by their year-end stock price to come up with the value of their equity. Next, the Department

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would be approximately $9.3 billion, much higher than Mr. Tegarden's $6 billion value for CSXT.

[14] In his appraisal report, Mr. Tegarden valued CSXT under the stock and debt approach at $9.637 billion. He testified that he gave little to no weight to this value because it did not include an illiquidity discount.

totaled the book value of the debt of these railroads, added the value of their equity, and subtracted cash items to derive each railroad's total market capitalization number. The Department then divided the total market capitalization number for each railroad by three different measures of income: revenues, EBIT,[15] and EBITDA.[16] This resulted in "multiples," which the Department applied against the same measures of income for CSXT to estimate the value of CSXT. The Department's market multiple values of CSXT were: (1) $12,246,460,000; (2) $10,769,011,960; and (3) $8,474,781,660 respectively.

CSXT primarily complains that the Department's calculation of its market multiple values is erroneous because the Department failed to make adjustments to its calculations to account for differences between these companies and CSXT. For example, CSXT argues that the Department failed to account for differences between the size of the comparator railroads and CSXT, whether they are eastern or western railroads, and the total amount of their assets. According to CSXT, if the Department had made the appropriate adjustments to reflect the differences between those railroads and CSXT, the appropriate market multiple value of CSXT would be approximately $6.08 billion.

Although the court applauds the Department's use of publicly traded Class 1[17] major railroads as comparable companies, the court finds that the Department erred when it failed to make adjustments to the size of the comparator companies. CSXT, however, has failed to introduce suf-

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[15] "EBIT" stands for "earnings before interest and tax."

[16] "EBITDA" stands for "earnings before interest, tax, and depreciation."

[17] As noted by Mr. Tegarden, the two Canadian railroads, Canadian National and Canadian Pacific, have enough revenue to be considered Class I railroads if they were U.S. companies.

ficient evidence for the court to determine what the appropriate adjustments should have been. At trial, CSXT introduced into evidence Plaintiff's Exhibit 51, which purports to adjust the values of Burlington Northern, Norfolk Southern, and Union Pacific to account for their size in comparison to CSXT. In addition to the fact that it does not make adjustments for all of the railroads used by the Department, it is not clear to the court whether the exhibit properly adjusts CSXT' s [sic] size to account for the purchase of Conrail. Nevertheless, because the Department erred in calculating its market multiple approach, the court will disregard the values the Department arrived at under its market multiple approach.

(4) *CSXT's Criticisms of the Department's Add-Back to Account for CSXT's Leased Equipment*

CSXT, like most railroads, leases substantial numbers of "rolling stock," such as locomotives and freight cars. The Conrail transaction was also structured using leases. CSXT uses operating leases to pay for various Conrail road assets. To account for this leased equipment and the Conrail road assets, the Department added $607 million to the unit value of CSXT under each of its valuation methods.

According to CSXT, the addition of $607 million to account for CSXT's leased assets is unnecessary because the Department's unit value of CSXT under all three valuation methods includes the value of all operating property owned or used by CSXT, including its leased assets. CSXT also argues that if the Department was going to treat CSXT's leased assets as if they were owned, the Department should have recognized that CSXT's capital expenditures would have increased if CSXT purchased its leased assets. If capital expenditures increased, then CSXT's cash flow would have been lower. The failure to make this adjustment to capital expenditures results in double counting the value of the leased assets.

In response, the Department points out that CSXT's operating leases are off-balance sheet financing. Because the operating leases do not show up on CSXT's balance sheet, the full value of the operating leases are not captured in CSXT's stock and debt prices or in the Department's income approach, unless certain adjustments are made.

After much deliberation, the court concludes that the Department did not improperly double count CSXT's leased assets. In particular, the court finds Dr. Ifflander and Mr. Dickerson's testimony on this issue credible.

There are two types of leases: capital leases and operating leases. A capital lease generally lasts for the life of an asset and the lease can be renewed at the end of the asset's life or the asset may be acquired at a favorable price. An operating lease usually lasts for a period of time much shorter than the actual life of the asset, and the present value of lease payments is generally much lower than the actual price of the asset. At the end of the life of the operating lease, the equipment usually reverts back to the lessor.

Under standard accounting rules, a capital lease is treated like a purchase. It shows up on a company's books as an asset, and the lease obligations show up as a liability or debt. Operating leases, on the other hand, do not show up on a company's books as an asset or a debt—they are off-balance sheet.[18] Instead, payments for operating leases show up as cash outflows from operations.[19]

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[18] The term "off-balance sheet" debt has been the focus of much attention in the last few years due to the Enron scandal. One of the principal ways in which Enron was able to deceive investors as to its value was by engaging in extensive off-balance sheet financing transactions, which shifted debt off Enron's balance sheet, making the company's balance sheet look far stronger than it actually was. *See* Lawrence E. Mitchell, *The Sarbanes-Oxley Act and the Reinvention of Corporate Governance?* Vill. L.Rev. 1189, 1212 (2003).

[19] "Off-balance sheet financing has been used for many years as a source of capital financing for acquiring heavy equipment, especially

When a lease arrangement is treated as off-balance sheet financing, the court is satisfied that there are "real current or future cash flow consequences." *See* 1 D.R. Carmichael & Paul Rosenfield, ACCOUNTANTS' HANDBOOK 33 (10th ed.2003). There are also consequences for reported earnings, book value of debt and capital, and return ratios for the company. The court finds that operating[20] and net income are lower, debt and capital for the firm are understated, and return on equity and capital are much higher. Unless an adjustment is made to the income statements to treat CSXT's leased Conrail road assets as if they were owned, the estimated market value CSXT will be understated.[21] In this case, the Department properly made such an adjustment—$607 million

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aircraft. . . ." John C. Murray, *Recharacterization and Title Issues in Synthetic Leasing Transactions*, 479 Practicing L. Inst./Real Est. Handbook 889 (2000).

[20] Operating income is a key input in both parties' valuation methods, but especially the DCF method.

[21] The court is aware of the fact that the Southern District of Iowa in *Burlington Northern Railroad Co. v. Bair*, 815 F.Supp. 1223, 1231 (S.D. Iowa 1993), reached a seemingly different conclusion. Although the *Bair* decision is not binding upon this court, the court points out that the *Bair* court's analysis on this issue is rather perfunctory. Further, in *Bair*, the court appears to have held that because commercial and industrial personal property is exempt from taxation, adding it back to the state's unit value estimations improperly double-counts the value of the leased rolling stock. *Id.* at 1231. In Georgia, however, taxable property is defined as "all real property, including but not limited to leaseholds, interests less than fee, and all personal property. . . ." O.C.G.A. § 48-5-3. Furthermore, Georgia law also states that a railroad's rolling stock and other personal property appurtenant to the rolling stock shall be taxed on "as much as the whole value of the rolling stock and personal property as the length of the railroad in this state bears to the whole length of the railroad, without regard to the location of the head office of the railroad. . . ." O.C.G.A. § 48-5-520. Thus, there does not appear to be a comparable tax exemption in Georgia.

to the unit value of CSXT under each of the Department's valuation methods.[22]

E. *The Court's Conclusions Regarding the True Market Value of CSXT*

After parsing through days of expert testimony, the court concludes that the Department's DCF value as set out in its Proposed Valuation is the most accurate indicator of CSXT's unit value. As a result, the court holds that, for purposes of applying the 4-R Act to the defendants' assessments of CSXT, the true market unit value of CSXT for the tax year 2002 was $7,726,293,350.[23]

The court finds that the portion of CSXT's true market value that should be allocated to Georgia for the tax year 2002 is 7.194059%. The true market value of CSXT's taxable rail transportation property in Georgia for the tax year 2002, therefore, was $509,560,171.[24]

Determining the true market value of CSXT does not end the inquiry. CSXT is only entitled to relief if the "ratio of [its] assessed value to [its] true market value . . . exceeds by at least 5% the ratio of assessed value to true market value of other commercial and industrial property in the same assessment jurisdiction." 49 U.S.C. § 11501(c). The parties have stipulated that the ratio of assessed value to true market

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[22] Except for arguing that no adjustment is necessary, CSXT has offered no evidence as to what the amount of the adjustment should have been.

[23] The court arrived at this number by taking the Department's $8,126,293,350 DCF value for CSXT and subtracting $400 million to account for CSXT's intangible property.

[24] The court reached this number by taking the $7,726,293,350 true market unit value of CSXT and allocating 7.194059% to Georgia. The court then deducted $4,156,193 to account for CSXT's motor vehicles, $2,907,467 to account for pollution control, and $39,210,271 to account for W & A exempt line.

value for all other commercial and industrial property in Georgia is 40%. For CSXT to succeed against the defendants, therefore, the ratio of assessed value to true market value of CSXT's rail transportation property in each assessment jurisdiction must be at least 42%.[25]

Regardless of whether the assessment jurisdiction is the county or the state, the ratio of assessed market value to true market value for CSXT's rail transportation property is less than 42%. As a result, the court concludes that the defendants have not discriminated against CSXT in violation of 49 U.S.C. § 11501(b)(1).

IV. *Whether the Defendants Singled Out CSXT for Discriminatory Treatment by Applying a Higher Valuation Approach to CSXT's Property than the Valuation Approach Applied to Other Centrally-Assessed Taxpayers in Georgia for the Tax Year 2002 in Violation of 49 U.S.C. § 11501(b)(4)*

The provisions of 49 U.S.C. § 11501(b)(4) forbid the imposition of any tax that discriminates against a railroad. The United States Supreme Court has held that when railroads are singled out for discriminatory treatment, discrimination under 49 U.S.C. § 11501(b)(4) has occurred. *See Department of Revenue of Oregon v. ACF Industries, Inc.*, 510 U.S. 332, 346-47, 114 S.Ct. 843, 851, 127 L.Ed.2d 165 (1994).

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[25] Section 11501(c) states that relief may be granted under this section "only if the ratio of assessed value to true market value of rail transportation property exceeds by at least 5% the ratio of assessed value to true market value of other commercial and industrial property in the same assessment jurisdiction." Once the 5% threshold is satisfied, the court is empowered to prevent all discrimination against the railroad. The 5% threshold is calculated by measuring 5% of 40%, which yields two percentage points. *See Southern Railway Co. v. State Board of Equalization*, 712 F.Supp. 1557, 1565-66 (N.D.Ga.1988).

CSXT claims that it has been singled out for discriminatory treatment because the Department did not attempt to assess the fair market value of other centrally-assessed taxpayers. Instead, CSXT claims that other centrally-assessed taxpayers are being taxed at whatever the Department determines is the lowest estimate of value that it could reasonably accept. CSXT argues that it is entitled to taxation on the same basis as these other centrally-assessed utilities-taxation based on the lowest possible value.

CSXT also argues that it has been treated differently than Norfolk Southern, the only other major railroad in Georgia. As evidence of this discrimination, CSXT points out that the Department consistently valued Norfolk Southern higher than CSXT, yet in the course of other litigation, the Department agreed to value Norfolk Southern at less than $8.2 billion for the tax year 2002.

A. *Whether CSXT Has Been Taxed Differently Than Other Centrally-Assessed Taxpayers*

CSXT first claims it has been singled out for discriminatory treatment because the Department's assessments of non-railroad centrally-assessed taxpayers are not based on the appraiser's opinion of the fair market value of those properties. In support of this claim, CSXT points out that Mr. Dickerson testified that he prepared proposed assessments for non-railroad utilities that represented the "lowest number he could come up with" and a "number at the lower end of his range of fair market value." Presumably because CSXT can come up with a lower number for its value than the Department, CSXT argues that it was treated differently than other centrally-assessed taxpayers.

The court finds CSXT' s [sic] argument unpersuasive. The evidence at trial showed that in preparing the Department's proposed valuations of CSXT and other taxpayers subject to the unit rule method, Mr. Dickerson first determined the

range within which he thought a particular company's fair market value could lie and then chose a number at the lower end of this range. CSXT was treated in the same manner as other public utilities; Mr. Dickerson came up with a range of values for CSXT and then picked a number that was closest to the lower end of that range. Further, the evidence at trial showed that Mr. Dickerson used essentially the same valuation methods to determine the unit value of all taxpayers subject to the unit rule method. The court finds Mr. Dickerson' s [sic] testimony on this issue to be credible.

Moreover, the fact that CSXT could come up with a lower number than the Department is meaningless. The Department did not base its valuation of other centrally-assessed taxpayers on the lowest number those taxpayers could come up with.[26] Instead, centrally-assessed taxpayers were taxed at the lowest number that Mr. Dickerson could come up with, just as CSXT was.

As further evidence that CSXT has been singled out for discriminatory treatment, CSXT argues that the Department's Proposed Valuation for 2002 is 47.1% higher than CSXT's 2001 assessment, whereas other non-railroad centrally-assessed taxpayers suffered only minimal increases. According to CSXT, this large increase was primarily caused by the exceedingly high terminal growth rate that Mr. Dickerson used in his DCF approach.

The fact that CSXT' s [sic] 2002 assessment was 47.1% higher than its 2001 assessment, and that this percentage increase is much higher than the percentage increase of other centrally-assessed taxpayers, does not in and of itself show that CSXT has been discriminated against. An equally likely proposition is that CSXT was undervalued in 2001. Further,

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[26] The court has no doubt that other centrally-assessed taxpayers could have come up with values lower than Mr. Dickerson' s proposed valuation of their property.

absent evidence of the fair market value of CSXT in 2001 or the fair market value of other taxpayers in 2002, the court cannot determine that CSXT has been singled out for discriminatory treatment.

Mr. Dickerson, moreover, testified that the largest part of the increase in CSXT's 2002 assessment was due to a change he instituted that year for all railroads, which was not needed for non-railroad public utilities. Specifically, he began using income data taken from CSX Corporation's annual reports instead of CSXT's R-1[27] reports to project future cash flows in his DCF analysis. Because those income figures can differ significantly from each other, the choice of which to use can greatly affect the DCF indicator of value. The evidence at trial showed that CSX Corporation's annual reports reflect management's view of CSXT's financial performance.

Finally, CSXT argues that the Department's treatment of other centrally-assessed taxpayers for the tax year 2004 is potent evidence that CSXT was singled out in 2002. In the tax year 2004, Mr. Dickerson devised a new way of calculating the risk premium for centrally-assessed taxpayers, which he then applied to his valuation worksheets for the tax year 2004. This new calculation increased the Department's initial valuation of the majority of centrally-assessed taxpayers, which, in turn, caused a "stir." The Department, in an attempt to avoid litigation, had a meeting with six representatives from centrally-assessed taxpayers, including CSXT. At the conclusion of the meeting, CSXT and the other five companies agreed that for the tax year 2004, all centrally-assessed taxpayers would receive an assessment equal to their assessment for the previous year or the average of their past three years of assessments, whichever was greater. For 2004, CSXT was assessed at $6.5 billion, a

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[27] An R-1 report is a report made by a railroad, such as CSXT, to the STB.

slight increase over the Department's 2001 assessment. Because the Department reverted to CSXT's 2001 values in 2004, CSXT argues that this is an indication that CSXT was singled out for different tax treatment in 2002 and 2003.

The Department's 2004 assessment of CSXT indicates little about the Department's 2002 valuation of CSXT. The Department negotiated an agreement with all public utilities in 2004 to avoid litigation. The agreement mandated that these taxpayers receive an assessment equal to their assessment for the previous year or the average of their past three years of assessments. As a practical matter, the Department could not have used either formula for CSXT because CSXT had filed suits challenging the Department's 2002 and 2003 valuations. The only avenue left to the Department was to revert to CSXT's 2001 assessment.

B. *Whether CSXT Has Been Treated Differently Than Norfolk Southern*

CSXT next argues that it has been treated differently than the only other major railroad in Georgia, Norfolk Southern. Like CSXT, Norfolk Southern filed suit against the defendants challenging the Department's 2002 assessment. The Department, however, settled Norfolk Southern's lawsuit and agreed to only minimal increases in value over the Department's 2001 assessment of Norfolk Southern. Ultimately, this meant that Norfolk Southern's 2002 value in Georgia was less than $8.2 billion.

CSXT argues that valuing Norfolk Southern less than CSXT for the tax year 2002 is wrong and discriminatory. CSXT points out that the Department consistently valued Norfolk Southern higher than CSXT for the tax years 2002-2004 and consistently projected higher cash flows for Norfolk Southern. If the Department truly believed that Norfolk Southern was worth more than CSXT, how, asks CSXT, could the Department assert in this suit that CSXT' s [sic]

value is higher than the agreed-to value of Norfolk Southern for the tax year 2002?

The court finds CSXT' s [sic] arguments unpersuasive. Nothing in the 4-R Act requires the court to compare the treatment of CSXT to just one company, another railroad. In *Atchison, Topeka, and Santa Fe Railway,* 78 F.3d at 442, the railroad argued that the court could measure whether Arizona's tax statutes discriminated against it solely by looking at the treatment of other motor carriers, as opposed to comparing all commercial and industrial taxpayers. The Ninth Circuit rejected this argument stating, "Although subsection(b)(4) is silent as to the proper comparison class, congressional intent behind the 4-R Act dictates that the comparison class of 'other commercial and industrial taxpayers subject to the tax' be used." *Id.*

The court finds the logic of the Ninth Circuit persuasive. By narrowing the comparison class to just one company, CSXT attempts to greatly expand the reach of the 4-R Act and increase the likelihood of future litigation. Accordingly, the court finds that it is improper to compare CSXT's treatment to just one other company, Norfolk Southern, for purposes of determining whether CSXT has been discriminated against in violation of the 4-R Act.

Even if it was proper to compare solely CSXT and Norfolk Southern, the court still finds that CSXT has not been singled out for discriminatory treatment. CSXT did not present any evidence that it was treated differently than Norfolk Southern when the Department made its initial proposed valuation of Norfolk Southern. If anything, the fact that Norfolk Southern also filed suit challenging the Department's proposed valuation suggests that Norfolk Southern was treated similarly to CSXT.

In addition, the fact that the Department ultimately settled with Norfolk Southern does not compel the court to conclude

that CSXT was treated differently from Norfolk Southern. Lawsuits are settled for numerous reasons, including the need to allocate scarce legal resources differently.

V. *Whether the Department Improperly Included the Value of CSXT's Intangible Property in Its Proposed Valuation in Violation of 49 U.S.C. § 11501(b)(4)*

CSXT's last claim is that the Department's Proposed Valuation includes amounts attributable to intangible property that is not taxed to locally-assessed taxpayers, resulting in a violation of 49 U.S.C. § 11501(b)(4). When a railroad is valued as a unit on a going concern basis, it is undisputed that the unit value of that railroad necessarily includes all of the railroad's assets, both tangible and intangible. The trend in a majority of states, however, is to exclude intangible property from ad valorem taxation. In 1996, the state of Georgia followed this trend and repealed its ad valorem tax on intangible property. *See* O.C.G.A. § 48-6-21. Thus, the intangible property of CSXT is not taxable in Georgia.

As an initial matter, the court must address the definition of the term "intangible property." Intangible property is generally defined as property that lacks a physical existence, such as stock options and business goodwill. *Black's Law Dictionary* 1253 (8th ed.2004). The court is not aware of any decision by the Georgia Department of Revenue or by Georgia courts that articulates a list of property included within the definition of "intangible property" for purposes of tax valuation. Under the repealed Georgia statute subjecting intangible property to an ad valorem tax, the Georgia legislature defined intangible property as:

(1) Money;

(2) Collateral Security Loans;

(3) Stocks;

(4) Accounts receivables and notes not representing credits secured by real estate;

(5) Bonds and debentures of all corporations;

(6) Long term notes secured by real estate;

(7) Short term notes secured by real estate;

(8) Restricted foreign intangibles;

(9) Patents, copyrights, franchises, and all other classes of intangible personal property not otherwise enumerated; and

(10) Computer software defined by statute.

O.C.G.A. § 48-6-21.

Although it has been repealed, O.C.G.A. § 48-6-21 is an indication that the Georgia legislature believed that the assets listed above constitute intangible property. Further, by repealing the statute, the legislature implicitly indicated that these types of intangible property were no longer subject to taxation. The court, therefore, finds that, at the very least, the list of property included in O.C.G.A. § 48-6-21 is a good starting point for defining the term "intangible property."

Despite the repeal of O.C.G.A. § 48-6-21, CSXT claims that its intangible property has been included within the Department's Proposed Valuation. The Department admits that its unit valuation of CSXT initially included CSXT' s [sic] tangible and intangible property, but claims that it deducted $400 million from its unit value to account for CSXT's intangible property.

Instead of attempting to identify and value its intangible property, CSXT contends that it is impractical to identify and value its intangible property, and, thus, the court should require the Department to use the yield capitalization approach, which CSXT contends does not compound intangibles. CSXT claims that the court should require the

defendants to use the yield capitalization approach because the Department's market multiple and stock and debt approaches allegedly unnecessarily compound intangible values.[28] For example, CSXT has presented evidence that a company's stock prices may increase when that company hires a new CEO. This increase in the stock price is not attributable to tangible assets. Because the stock and debt and the market multiple approaches both rely on a company's stock price,[29] they compound intangible assets.

As support for its argument that the court should adopt the yield capitalization approach, CSXT cites to a decision by the Utah Tax Commission ("Commission") in *WilTel, Inc. v. Beaver County*, Nos. 95-0789 and 95-0824 (Utah Tax Commission December 5, 1997)("*WilTel II*"). WilTel, Inc. is a provider of long-distance telecommunications services. In 1995, the Utah State Property Tax Division (the "Division") calculated WilTel's unit value based on the stock and debt and income approaches. WilTel appealed the assessment to the Utah Tax Commission and moved for partial summary judgment arguing, in part, that Utah's assessment improperly included intangible property, which was not taxable under Utah law. *WilTel, Inc. v. Beaver County*, No. 95-0789, 1997 Utah Tax LEXIS 111, at *2-3 (Utah Tax Commission April 21, 1997) ("*WilTel I*"). The Utah Tax Commission found that the income and stock and debt approaches tend to compound intangible values. The Utah Tax Commission then remanded the case to the parties to identify, value, and re-

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[28] It is undisputed here that the Department does not and did not intend to value the intangible property of other commercial and industrial property. It is also undisputed that all three of the valuation methods used by the Department initially included the value of CSXT's intangible property.

[29] For clarification purposes, unlike the stock and debt approach, the market multiple approach relies on the stock prices of comparable companies, as opposed to CSX Corporation's stock prices.

move WilTel's intangible property using the cost approach." *Id.* at *14-15.

On remand, the parties were unable to agree on the valuation of WilTel's tax-exempt intangible property, and, thus, the matter came before the Utah Tax Commission again for a formal hearing to determine the value of WilTel's intangible property. *WilTel II* at *2. The Commission finally concluded that "separately valuing intangibles and deducting them from a unit valuation is impractical." *WilTel II* at *3. In an attempt to minimize the inclusion of intangibles in the unit rule method, the Utah Tax Commission concluded that the parties should use a yield capitalization approach and a cost approach and that each approach should be weighted at 50%. The Utah Tax Commission then remanded the case to the Division to calculate the value of WilTel under a yield capitalization approach (minus growth) and to time adjust its cost approach. *WilTel II* at *6.

While the *WilTel II* decision is attractive because of its simplicity, the court finds that the reasoning of *WilTel II* is not appropriate in this case. First, this is a case brought under the 4-R Act, and not merely an appeal of a state tax valuation. The court has already held that CSXT may not challenge the Department's valuation methods in this case. If this court were to adopt the reasoning of *WilTel II*, the court would be dictating to the Department a particular valuation method.

Second, CSXT has not convinced the court that it is impossible or impractical to value its intangible property. While CSXT's local assessment expert, Ms. Judith Ross, testified that identifying and valuing a company's intangible property would be extremely difficult, she also testified that performing a unit valuation in general is difficult. Ms. Ross further testified that intangible property can be identified and valued by a person with expertise. Thus, the court finds that it is not impractical or impossible to identify and value CSXT's intangible property.

Third, while the court believes that the stock and debt approach undoubtedly includes value attributable to intangible property in its initial unit value, the court also finds that the yield capitalization method touted by CSXT includes some value attributable to intangible property. In fact, CSXT has admitted that Mr. Tegarden's yield capitalization value includes some value attributable to intangible property. This is further illustrated by the fact that CSXT deducts $400 million from Mr. Tegarden's unit value of CSXT—the same $400 million deduction that the Department took to account for certain intangibles owned by CSXT.

Fourth, this case differs[30] from the *Wiltel* decisions in that in *Wiltel I*, the Utah Tax Commission remanded the case so that the taxpayer could identify its intangible property. The parties, however, could not agree on the value of Wiltel's intangible property. In this case, CSXT has not even presented any evidence that it owns intangible property.

Here, it is undisputed that Mr. Dickerson deducted $400 million from his unit value of CSXT to account for certain intangibles. He testified that the $400 million deduction was his attempt to eliminate the value of CSXT's intangible property that was previously separately taxed under O.C.G.A. § 48-6-21. When asked why he did not attempt to value and deduct other intangible property from his initial assessment, Mr. Dickerson testified that CSXT did not present the Department with any evidence that CSXT owned other intangible property. Consistent with its statement to Mr. Dickerson, at trial CSXT failed to identify any specific intangible property

[30] The court also notes that holdings in the *WilTel* cases are not binding upon this court for numerous reasons: (1) the *Wiltel* decisions were made by the Utah State Tax Commission; (2) the taxpayer in the *Wiltel* cases was a telecommunications company, not a railroad; and (3) the *Wiltel* cases were not decided under the 4-R Act.

that it owned as of January 1, 2002.[31] CSXT also failed to present evidence as to how much its intangible property was worth. *Cf. Burlington N. R.R. Co. v. Huddleston*, 94 F.3d 1413, 1415 (10th Cir.1996) (in its complaint alleging a violation of the 4-R Act, the railroad also alleged that the value of its intangible property, computer software, was at least $8 million); *Bair*, 815 F.Supp. at 1239 (separately identifying and valuing intangible property of a railroad for purposes of 4-R Act claim). Nor has CSXT provided the court with any evidence that the Department's $400 million intangible property deduction was under-inclusive.

The court, therefore, concludes that CSXT has not carried its burden of showing by a preponderance of evidence that the Department improperly included intangible property in the Department's Proposed Valuation of CSXT.

Conclusion

For the reasons discussed above, the court concludes that the defendants have not discriminated against CSXT in violation of 49 U.S.C. § 11501(b)(4).

The court also holds that the true market unit value of CSXT for the tax year 2002 was $7,726,293,350.[32] The true market value of CSXT's taxable rail transportation property in Georgia for the tax year 2002 was $509,560,171.[33] The defendants, therefore, have not discriminated against CSXT

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[31] For example, CSXT did not provide the court with any evidence that it owns any trademarks, copyrights, or patents.

[32] The court arrived at this number by taking the Department's $8,126,293,350 DCF value for CSXT and subtracting $400 million to account for CSXT's intangible property.

[33] The court reached this number by taking the $7,726,293,350 true market unit value of CSXT and allocating 7.194059% to Georgia. The court then deducted $4,156,193 to account for CSXT's motor vehicles, $2,907,467 to account for pollution control, and $39,210,271 to account for W & A exempt line.

in violation of 49 U.S.C. § 11501(b)(1) because the ratio of assessed value to true market value of CSXT's property does not exceed the jurisdictional threshold set out in the 4-R Act of 42%. Thus, CSXT is not entitled to relief under the 4-R Act for the tax year 2002.

The clerk is DIRECTED to close this file and issue judgment for the defendants in accordance with this order.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CIVIL ACTION FILE NO. 1:02-cv-2634-CAP

CSX TRANSPORTATION, INC.,
Plaintiff,

vs.

THE STATE BOARD OF EQUALIZATION
OF THE STATE OF GEORGIA; *et. al.*
Defendant.

JUDGMENT

This action having come before the court, Honorable Charles A. Pannell, Jr., United States District Judge, for consideration it is

Ordered and Adjudged that the Defendants have not discriminated against CSXT in violation of 49 U.S.C. § 11501(b)(1). This action is dismissed.

Dated at Atlanta, Georgia, this 29th day of September, 2005.

LUTHER D. THOMAS
CLERK OF COURT

By: /s/ Don Stanhope
Deputy Clerk

UNITED STATES COURT OF APPEALS
ELEVENTH CIRCUIT

No. 05-16000

CSX TRANSPORTATION, INC.,
Plaintiff-Appellant,

v.

STATE BOARD OF EQUALIZATION, of the State of Georgia, JERRY JACKSON, as Commissioner of Revenue of the State of Georgia, RUSSELL W. HINTON, as State Auditor of the State of Georgia, RAY J. CRAWFORD, as Director of the Georgia State Properties Commission
Defendants-Appellees.

Dec. 19, 2006

Appeal from the United States District Court
for the Northern District of Georgia.

Before BIRCH, PRYOR and FAY, *Circuit Judges.*

PRYOR, *Circuit Judge:*

This appeal presents a question about state taxation of railroad properties that was expressly left open by the Supreme Court of the United States, has since divided the federal appellate courts, and involves the traditional balance of federal and state power. We are asked to decide whether section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act or the Act), 49 U.S.C. § 11501, allows a railroad to challenge the methodology by which a state determines the true market value of railroad property for *ad valorem* tax purposes. The 4-R Act provides an exception to the general rule of the Tax Injunction Act that federal

district courts will not interfere with matters of state taxation. *Compare id. with* 28 U.S.C. § 1341. This appeal turns on the breadth of that exception.

CSX Transportation, Inc. (the Railroad) filed a complaint against the State Board of Equalization of Georgia (the Board), under section 306 of the Act, in which it challenged the appraisal of its property by the Board at $8.2 billion. Section 306 requires, for purposes of levying a property tax, that the ratio of assessed value to true market value of railroad property not exceed by more than five percent the ratio of assessed value to true market value of all other commercial and industrial property in the same assessment jurisdiction. 49 U.S.C. § 11501(c). The district court refused to consider an appraisal proffered by the Railroad that valued the property of the Railroad at $6 billion because the district court concluded that the appraisal was based on a valuation methodology different from the one used by the State. *CSX Transp. v. State Bd. of Equalization*, 448 F.Supp.2d 1330, 1348 (N.D.Ga.2005). The Railroad argues that the 4-R Act allows it to challenge the valuation methodology of a state. Because the Act does not clearly state that railroads may challenge state valuation methodologies, we affirm the judgment of the district court.

I. BACKGROUND

The Railroad is a wholly-owned subsidiary of CSX Corporation. In tax year 2002, the Railroad provided freight transportation over a network that included a route through the State of Georgia. In Georgia, public utilities are centrally-assessed taxpayers, and public utilities include railroads, investor-owned electric utilities, investor-owned telephone companies, pipeline companies, and gas distribution companies. Although most taxpayers in Georgia are assessed, in the first instance, by county boards of assessors, the State Revenue Commissioner issues proposed assessments of the property of centrally-assessed taxpayers for each county in

which the taxpayer owns taxable property. The Property Tax Division of the Georgia Department of Revenue (the Department) prepares a digest of public utility assessments that the Board reviews and approves. The Board then certifies the proposed assessments to each county in which taxable property is owned. Ga.Code Ann. § 48-2-18(c). Each county "may, but is not required to, use these figures as the county's own tax assessment." *Colonial Pipeline Co. v. Collins*, 921 F.2d 1237, 1240-41 (11th Cir.1991). For 2002, 59 of the 71 Georgia counties in which the Railroad owned taxable property adopted the proposed assessment of the Board.

In 2002, as in preceding years, the Department determined the value of all public utilities using the unit rule. Under this rule, an appraiser first determines the value of all assets of an entity, regardless of location. That amount is then multiplied by the percentage of the entity located within Georgia to determine what portion of the value of the company should be allocated to the state. The Railroad agrees that the unit rule is a proper method of valuation under Georgia law.

Although there are several different methods for determining the value of a company or property under the unit rule, those methods fall into three general categories: the sales comparison approach, the cost approach, and the income approach. Under a sales comparison approach, a company or property is appraised by examining actual sales of comparable companies or properties. Under the cost approach, an appraiser adds together the original costs of the various components of a company or property and makes deductions for depreciation or obsolescence. Under an income approach, an appraiser determines the future income stream of a company or property over the life of the company or property.

Gregg Dickerson prepared the valuation worksheets for the appraisal of the Railroad in 2002. Dickerson was an appraiser with 30 years of experience, including experience regarding the use of the unit rule in public utility valuation.

Dickerson performed unit valuations at the Department for ten years before leaving in 1993 to work in the tax department at Norfolk Southern Railroad. Dickerson returned to the Department in 2001 to serve as the Program Manager of its Public Utilities section.

When Dickerson returned to the Department, he altered the combination of valuation methods the Department used to calculate value under the unit rule. The Department had been calculating the unit values of all public utilities using a yield capitalization method (an income approach), a direct capitalization method (another income approach), and a stock and debt method (a sales comparison approach). For tax year 2002, Dickerson replaced the first two methods with a discounted cash flow method (an income approach) and a market multiples method (a sales comparison approach). Dickerson retained the third method.

Dickerson appraised the property of the Railroad using these three methods. He first used the stock and debt method, which assumes that the value of a company equals the sum of its outstanding debt and its equity. Under this method, Dickerson's appraisal was $12.022 billion.

Dickerson next used the discounted cash flow method. Under this method, an appraiser first projects the cash flows of a company for a designated number of years after the assessment date and discounts those expected cash flows to their present value. The appraiser then calculates a terminal or reversion value that represents the value of the company at the end of the projection period. These two values together give the appraiser his unit value for the company. Dickerson calculated four terminal values using different indicators of reversion. The unit value calculated using a terminal growth rate of 63 percent was the lowest of the four, and Dickerson selected that value. Dickerson's appraisal, under this method, was $8,126,293,350.

Finally, Dickerson used the market multiples method. This method requires an appraiser to derive market multiples from the stock prices of companies engaged in similar lines of business and compare those multiples with the subject company to determine its value. Dickerson performed three different market multiples analyses, which resulted in appraisals of $12.346 billion, $10.769 billion, and $8.474 billion.

The five values derived from these three methods gave Dickerson a valuation range of $8.126 to $12.346 billion. As he did with all public utilities that year, Dickerson selected an amount at the lower end of that range to avoid potential litigation. Dickerson selected $8.2 billion as the lower limit of what the unit value of the Railroad might reasonably be. He then deducted $400 million to account for intangible property not subject to *ad valorem* taxation. Ga.Code Ann. § 48-6-21. The adjusted unit value of $7.8 billion was multiplied by 7.194059 percent, which was the percentage of the track of the Railroad located in Georgia, which resulted in an allocated value of $561,136,602. Dickerson made further deductions for motor vehicles, pollution control equipment, and an exempt rail line, and he arrived at a taxable fair market value of $514,862,672.

The Railroad filed a complaint under the 4-R Act that challenged the valuation proposed by the Department. The Act bars states from discriminating against railroads when levying property taxes:

> The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them:
>
> (1) Assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in

> the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
>
> (2) Levy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection.
>
> (3) Levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
>
> (4) Impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Board under this part.

49 U.S.C. § 11501(b).

When a violation of the 4-R Act reaches a certain quantitative threshold, redress is allowed as an exception to the Tax Injunction Act, 28 U.S.C. § 341, which ordinarily bars challenges of state taxation practices in federal courts:

> Notwithstanding section 1341 of title 28 and without regard to the amount in controversy or citizenship of the parties, a district court of the United States has jurisdiction, concurrent with other jurisdiction of courts of the United States and the States, to prevent a violation of subsection (b) of this section. Relief may be granted under this subsection only if the ratio of assessed value to true market value of rail transportation property exceeds by at least 5 percent the ratio of assessed value to true market value of other commercial and industrial property in the same assessment jurisdiction. The burden of proof in determining assessed value and true market value is governed by State law.

49 U.S.C. § 11501(c).

The Railroad argued that it was taxed at a higher ratio of assessed value to true market value than other commercial

and industrial property, in violation of section 11501(b)(1), because the true market value of its property for 2002 did not exceed $6 billion. The Railroad submitted an appraisal prepared by Thomas Tegarden, whose credentials the district court described as "impeccable." *CSX Transp.*, 448 F.Supp.2d at 1333. Tegarden used three valuation methods, two of which had not been used by the Department: a stock and debt method, a cost method, and a yield capitalization method. These methods produced valuations of $9.367 billion, $6.15 billion, and $5.983 billion, respectively. Tegarden gave no weight to his stock and debt value, little weight to his cost value, and primary weight to his yield capitalization value, and concluded that the unit value of the Railroad for tax year 2002 did not exceed $6 billion. Tegarden made the same adjustments as the Department for intangible property, motor vehicles, pollution control equipment, and the exempt rail line, and applied the same track-mile percentage, which resulted in a taxable fair market value of not more than $369,253,752.

The district court concluded that it was not permitted to consider Tegarden's appraisal. The district court interpreted the 4-R Act to bar consideration of appraisals based on a valuation methodology different from the methodology used by the State, unless the methodology of the State is irrational or intentionally discriminatory. *Id.* at 1342. The court rejected the argument that Tegarden's valuation methodology was a variant of the same methodology used by the State. *Id.* at 1343.

The Railroad also challenged the accuracy of several calculations by the Department in its appraisal. In one of these challenges, the Railroad argued that the Department erred in using 6.3 percent as the terminal growth rate in its discounted cash flow valuation. The terminal growth rate plays a central role in determining the terminal or reversion value in the discounted cash flow method of valuation.

Dickerson testified that he chose this rate because it is the long-term growth rate of the gross domestic product and is the type of rate the market would use to estimate the terminal value of a company using a discounted cash flow method. The Railroad argued that this rate was higher than the growth rate used to project cash flows through 2011 (the first half of the discounted cash flow valuation) and, because the Department projected that the revenue of the Railroad would grow at only 2 percent, a growth rate of 6.3 percent would require that expenses become negative.

The district court found that the testimony of the experts of the Railroad on this issue lacked credibility. *Id.* at 1345. The court also found that these experts never stated what the growth rate should actually be. At most, their testimony suggested the Department should have used a rate of 3.5 percent or 4.5 percent, but the court concluded that these rates suffered from the same infirmities as the 6.3 percent rate, including that they would require expenses to become negative. *Id.*

After rejecting the arguments of the Railroad, the district court concluded that the true market value of the Railroad for tax year 2002 was $7,726,293,350. *Id.* at 1350. The court found the figure produced by the discounted cash flow method to be the most accurate appraisal of the value of the Railroad, and the court subtracted $400 million from the discounted cash flow value of the Department ($8,126,293,350) to account for intangible property. *Id.* at 1350 n. 23. The court concluded that the ratio of assessed value to true market value of the property of the Railroad did not exceed by more than five percent the ratio of assessed value to true market value of the other commercial and industrial property in the assessment jurisdiction of the Railroad. *Id.* at 1350. The district court entered a judgment in favor of the Board.

II. STANDARDS OF REVIEW

We review factual findings of the district court for clear error and conclusions of law *de novo*. *Glassroth v. Moore*, 335 F.3d 1282, 1296-97 (11th Cir.2003).

III. DISCUSSION

The Railroad raises three challenges to the determination by the district court of its true market value for tax year 2002. The Railroad first contends that the district court erred in holding that the 4-R Act bars a railroad from challenging the valuation methodology chosen by a state. Second, the Railroad argues that, even if it is barred from challenging the methodology of the Board, the appraisal of Tegarden should have been considered by the district court because that appraisal was based on the same methodology used by the Board. Third, the Railroad maintains that the district court clearly erred in accepting the use by the Board of a terminal growth rate of 6.3 percent in its discounted cash flow valuation. We address each argument in turn.

A. The 4-R Act Does Not Allow a Railroad to Challenge the Methodology by Which a State Determines Fair Market Value.

Whether a railroad may challenge, under the 4-R Act, the valuation methodology of a state is a question the Supreme Court has acknowledged but not decided. When it first interpreted the 4-R Act in *Burlington Northern Railroad v. Oklahoma Tax Commission*, the Court held that a railroad need not prove intentional discrimination to challenge factual determinations made by a state in the application of its valuation methodology. 481 U.S. 454, 462-63, 107 S.Ct. 1855, 1860-61, 95 L.Ed.2d 404 (1987). In a footnote, the Court expressly refrained from deciding whether the Act allows a railroad to challenge the valuation methodology itself:

> This case therefore does not present the question whether a railroad may, in an action under § 11503 [now

> § 11501], challenge in the district court the appropriateness of the accounting methods by which the State determined the railroad's value, or is instead restricted to challenging the factual determinations to which the State's preferred accounting methods were applied. Accordingly we express no view on that issue.

Id. at 463 n. 5, 107 S.Ct. at 1861 n. 5.

Three of our sister circuits, following *Burlington Northern v. Oklahoma*, have split on whether railroads may challenge state valuation methodologies. The Fourth Circuit, on the one hand, has concluded that the 4-R Act does not permit a railroad to challenge the valuation methodology of a state. That circuit concluded that the text of the Act is ambiguous, and the court was "not inclined to disregard" the general policy of noninterference in matters of state taxation contained in the Tax Injunction Act "where § 306 does not plainly authorize such an exception." *Chesapeake W. Ry. v. Forst*, 938 F.2d 528, 531 (4th Cir.1991); *accord Richmond, Fredericksburg & Potomac R.R. Co. v. Forst*, 4 F.3d 244, 250 (4th Cir.1993). The Second and Ninth Circuits, on the other hand, have repudiated *Chesapeake Western* and held that railroads may challenge valuation methodologies. In *Burlington Northern Railroad v. Department of Revenue*, the Ninth Circuit explained that section 11501(c) of the 4-R Act provides that state law governs the burden of proof in challenges to assessed value and true market value. 23 F.3d 239, 241 (9th Cir.1994). Because determinations of property value by public officials in the State of Washington may be defeated by "clear, cogent and convincing evidence," the court reasoned that state valuation methodologies may likewise be defeated by clear, cogent, and convincing evidence. *Id.* In *Consolidated Rail Corp. v. Town of Hyde Park*, the Second Circuit held that, at least where states use a unique method to appraise railroads, the 4-R Act allows railroads to challenge valuation methodology. 47 F.3d 473, 482 (2d Cir.1995).

The Railroad argues that *Chesapeake Western* was wrongly decided and urges us to follow *Burlington Northern v. Department of Revenue* and *Consolidated Rail* in allowing railroads to challenge valuation methodology. The Railroad contends that the 4-R Act allows a challenge of any act, including the choice of a methodology, that has the effect of discriminating against railroads. The Railroad relies on the statement of the Court in *Burlington Northern v. Oklahoma* that the Act "speaks only in terms of 'acts' which 'unreasonably burden and discriminate against interstate commerce'; nowhere does it refer to the intent of the actor." 481 U.S. at 463, 107 S.Ct. at 1861.

The Railroad also relies on broad statements in previous decisions of our Court. The Railroad reminds us that we have stated that "[t]he legislative history and broad language of the Act show Congress possessed a general concern with discrimination in all of its guises." *S. Ry. v. State Bd. of Equalization*, 715 F.2d 522, 528 (11th Cir.1983). We also have stated that "Congress meant unconditionally to ensure a federal forum for section 11503 [now section 11501] claims." *Id.* at 527.

Notwithstanding our earlier dicta to the contrary, we are persuaded that the Fourth Circuit correctly interpreted the 4-R Act as being subject to a clear statement rule. It is a well-settled principle of statutory interpretation that a statute will not be construed to burden states in the exercise of their traditional powers unless it clearly states its intent to do so. "'If Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute.'" *Gregory v. Ashcroft*, 501 U.S. 452, 460-61, 111 S.Ct. 2395, 2401, 115 L.Ed.2d 410 (1991) (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242, 105 S.Ct. 3142, 3147, 87 L.Ed.2d 171 (1985)). "This plain statement rule is nothing more than an acknowledgment that the States

retain substantial sovereign powers under our constitutional scheme, powers with which Congress does not readily interfere." *Id.* at 461, 111 S.Ct. at 2401.

Perhaps the most fundamental power of a sovereign is the power to tax. This power was originally considered so integral a power of the states as to admit of no abridgement by the federal government, *see* The Federalist No. 32 (Alexander Hamilton), and its singular importance to the states has been repeatedly acknowledged. *See Dep't of Revenue v. ACF Indus.*, 510 U.S. 332, 345, 114 S.Ct. 843, 850, 127 L.Ed.2d 165 (1994) (power to tax is "central to state sovereignty"); *Bode v. Barrett*, 344 U.S. 583, 585, 73 S.Ct. 468, 470, 97 L.Ed. 567 (1953) (power of a state to tax is "basic to its sovereignty"); *Curry v. McCanless*, 307 U.S. 357, 366, 59 S.Ct. 900, 905, 83 L.Ed. 1339 (1939) (power to tax is "incident to" and "coextensive with" sovereignty). This understanding of the relationship of sovereignty and taxation is implicit: "It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments." *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110, 20 L.Ed. 65 (1871).

The selection of a valuation methodology is part of this fundamental power of a state. *See Louisville & Nashville R.R. v. Dep't of Revenue, Fla.*, 736 F.2d 1495, 1498 (11th Cir.1984) ("These arguments broach delicate issues implicating the state's traditional authority to select methods of valuation."). Important questions of state policy are often intertwined with the selection of a valuation methodology. Time pressures and limited resources, for example, may compel a state to choose a simple valuation methodology rather than a complicated one. *See, e.g., Union Pac. R.R. v. State Tax Comm'n*, 716 F.Supp. 543, 557 (D.Utah 1988).

The Supreme Court has "long recognized that principles of federalism and comity generally counsel that courts should adopt a hands-off approach with respect to state tax admin-

istration." *Nat'l Private Truck Council v. Okla. Tax Comm'n*, 515 U.S. 582, 586, 115 S.Ct. 2351, 2354, 132 L.Ed.2d 509 (1995). Because the states rely so heavily on their ability to tax, "'it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible.'" *Id.* (quoting *Dows*, 78 U.S. (11 Wall.) at 110). When Congress enacted the Tax Injunction Act, it "intended to codify this pre-existing federal equity practice and to ensure more uniform adherence to the underlying principles of comity." *S. Ry.*, 715 F.2d at 527; *see also 28 E. Jackson Enters. v. Cullerton*, 523 F.2d 439, 441 (7th Cir.1975) (Tax Injunction Act "codifies the well-established federal policy of noninterference in matters of state taxation").

The Railroad argues that principles of federalism and comity should play no role in our interpretation of the 4-R Act. This argument is not new. We have stated that "Congress intended to carve out an exception not only to the Tax Injunction Act, but also to the underlying doctrine of equitable restraint in the narrow area of discriminatory taxation of railroads," *S. Ry.*, 715 F.2d at 529, and the Eighth Circuit has stated that "[t]he common law principle of federal deference to state tax schemes, as amplified by 28 U.S.C. § 1341, has no place in a § 306 analysis," *Burlington N. R.R. v. James*, 911 F.2d 1297, 1300 (8th Cir.1990).

The problem with this argument is that more recently the Supreme Court has stated the opposite. In a decision mentioned by neither the Ninth Circuit in *Burlington Northern v. Department of Revenue* nor the Second Circuit in *Consolidated Rail*, the Supreme Court ruled in 1994 that states may grant exemptions from a generally applicable *ad valorem* property tax without subjecting the taxation of railroad property to challenge under subsection (b)(4) of the Act. *ACF Indus.*, 510 U.S. at 335, 114 S.Ct. at 846. The Court reached this conclusion based on the text of the Act, *id.* at

339-43, 114 S.Ct. at 848-50, and then explained, "Principles of federalism support, in fact compel, our view. Subsection (b)(4), *like the whole of § 11503* [now § 11501], sets limits upon the taxation authority of state government, an authority we have recognized as central to state sovereignty," *id.* at 345, 114 S.Ct. at 850 (emphasis added). The Court stated that principles of federalism required the use of a clear statement rule in this context. *Id.* at 345, 114 S.Ct. at 850-51. Because it was not the "clear and manifest purpose of Congress" to allow railroads to challenge property tax exemptions in federal court, the Court refused to read the 4-R Act as granting them that right. *Id.*

Based on the reasoning of the Court in *ACF Industries*, we conclude that railroads may not challenge state valuation methodologies under subsection (b)(1). The text of the Act does not clearly state that railroads may challenge valuation methodologies. Without that clear statement of congressional intent, the argument of the Railroad fails.

The legislative history, "to the extent it has any relevance to our inquiry," *ACF Indus.*, 510 U.S. at 345, 114 S.Ct. at 851, supports the conclusion that railroads may not challenge state valuation methodologies in federal court. The committee report regarding a precursor of section 306 explained that the bill "does not suggest or require a State to change its assessment standards, assessment practices, or the assessments themselves. It merely provides a single standard against which all affected assessments must be measured." S.Rep. No. 90-1483, app. B, at 22 (1968). The testimony of a railroad representative at a hearing on an earlier version of section 306 was consistent with this interpretation: "The standards and methods of valuation that any State wishes to use would be unaffected by this legislation." *Hearing on H.R. 16245 Before the Subcomm. on Transp. & Aeronautics of the H. Comm. on Interstate & Foreign Commerce*, 91st Cong. 138 (1970) (statement of Philip M. Lanier).

The most that can be said for the argument of the Railroad is that it was articulated ably in the dissenting opinion in *ACF Industries*. Justice Stevens argued that "the text of subsection (b)(4) and its evident purposes convince me that Congress intended to bar discrimination by any means, including exemptions." *ACF Indus.*, 510 U.S. at 350, 114 S.Ct. at 853 (Stevens, J., dissenting). The lower court that the Supreme Court in *ACF Industries* reversed also reached this conclusion. *See id.* at 338, 114 S.Ct. at 847 ("The court [of appeals] explained that Congress enacted § 11503 [now § 11501] to 'prevent tax discrimination against railroads *in any form whatsoever.*'" (citation omitted)). We obviously are not at liberty to follow either Justice Stevens's dissenting opinion or the decision reversed by the Supreme Court. The district court was not allowed to consider a valuation methodology different from the methodology of the Board.

B. The District Court Did Not Clearly Err in Finding That the Railroad Used a Valuation Methodology Different From the Methodology of the State.

The Railroad and an amicus curiae argue, in the alternative, that the appraisal by Tegarden was based on the same methodology used by the State. The American Association of Railroads, as amicus curiae, argues that there is a tri-partite taxonomy of appraisal terminology consisting in unit rule and summation "methodologies"; income, cost, and market "approaches" for determining value under the unit rule; and stock and debt, discounted cash flow, yield capitalization, and other "techniques" for implementing the various approaches. Under this taxonomy, our decision in subsection III.A would bar the Railroad from challenging only the adoption of the unit rule.

Although this taxonomy may be useful within the appraisal community, there is little legal support for this argument. The Association argues that the Fourth Circuit has used the terms "method" and "methodology" in the way it advocates,

see Chesapeake W. Ry., 938 F.2d at 529, but other courts have used those terms to designate more specific components of the valuation process. *See, e.g., Consol. Rail*, 47 F.3d at 477 (discussing "the 'income capitalization method'" and "the 'stock and debt method'"); *Union Pac. R.R.*, 716 F.Supp. at 551 (referring to "yield capitalization" and "direct capitalization" as different methods and methodologies).

The more serious problem for the Association is that its argument is contrary to the understanding of the Supreme Court. A close reading of footnote 5 of *Burlington Northern v. Oklahoma* establishes that the Supreme Court understands the phrase "accounting methods" to encompass all nonfactual determinations made in the process of appraising a railroad. We quote the text of that footnote as follows, with our emphasis on three key phrases:

> This case therefore does not present the question whether a railroad may, in an action under § 11503 [now § 11501], challenge in the district court the appropriateness of the *accounting methods* by which the State determined the railroad's value, *or is instead restricted* to challenging the *factual determinations* to which the State's preferred accounting methods were applied. Accordingly we express no view on that issue.

481 U.S. at 463 n. 5, 107 S.Ct. at 1861 n. 5 (emphasis added).

This language suggests that there are only two categories in the valuation process, and the Court understood "accounting methods" and "factual determinations" to be exhaustive of all possibilities. It would not make sense to say that railroads, if barred from challenging accounting methods, would be "instead restricted" to challenging factual determinations if there were some third category in the valuation process, such as an "approach" or "technique," as the Association argues. The inability of railroads to challenge accounting methods restricts the railroads to challenging factual determinations.

The term "accounting methods" and the parallel term "valuation methodology" as used by the Supreme Court encompass all nonfactual determinations involved in constructing a valuation process, regardless of how broad or narrow they may be.

The definition of a "methodology" also should be understood in the light of the principles of federalism that govern our interpretation of the 4-R Act. Under the taxonomy advanced by the Association, a railroad would be barred from challenging the decision to use the unit rule, but permitted to challenge the use of a combination of the stock and debt method and a market multiples approach instead of a yield capitalization method and a cost approach. We are reluctant to allow that kind of freewheeling judicial second-guessing, which implicates delicate matters of state policy, *cf. Union Pac. R.R.*, 716 F.Supp. at 557 (explaining what might influence a choice between a direct capitalization and a yield capitalization method), without clear support in the text of the Act. We would expect Congress to state unambiguously its intention to subject states to challenges of both kinds of decisions in federal court.

Based on our understanding of the term "methodology," the district court did not clearly err in finding that the appraisal prepared for the Railroad by Tegarden was based on a methodology different from the methodology used by the State. The State appraised public utilities in 2002 by calculating five values under three different methods and selecting a figure at the low end of the resulting range. Tegarden calculated three values using three methods, only one of which had been used by the State. Instead of selecting a figure at the low end of his resulting range, Tegarden weighted each result, giving primary weight to one of the methods—yield capitalization—not used by the State. Even if the Railroad were able to convince us that the yield capitalization and discounted cash flow methods are alge-

braically the same, this conclusion would not establish that Tegarden used the same valuation methodology as the State. The State did not give primary weight—or any weight—to its discounted cash flow valuation. The selection by the Department of an appraisal amount nearest to the discounted cash flow number did not reflect the conclusion that discounted cash flow was the most accurate of the methods used, only that it was the lowest.

C. The District Court Did Not Clearly Err When It Accepted the 6.3 Percent Terminal Growth Rate Used by the State.

Finally, there was no clear error by the district court in its finding that the use of a terminal growth rate of 6.3 percent by the Board, in its discounted cash flow valuation, was acceptable. A factual finding "is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Anderson v. City of Bessemer City*, 470 U.S. 564, 573-74, 105 S.Ct. 1504, 1511, 84 L.Ed.2d 518 (1985) (internal quotations and citations omitted). We cannot say definitively that the district court made a mistake because its finding rested on issues of expert credibility.

Although the experts employed by the Railroad testified that a terminal growth rate of 6.3 percent was too high, Dickerson explained why he found it to be appropriate, including that 6.3 percent is the long-term growth rate of the gross domestic product. The district court stated that it found the experts of the Railroad to lack credibility on this issue. *CSX Transp.*, 448 F.Supp.2d at 1345. We have previously said that we "should be reluctant to overturn the district court's findings" where those findings are based on "crucial evaluations of witness credibility, particularly where the expert testimony conflicted." *L&C Marine Transp., Ltd. v. Ward*, 755 F.2d 1457, 1461 (11th Cir.1985).

The district court also based its finding on the failure of the Railroad to state what the terminal growth rate should be. *CSX Transp.*, 448 F.Supp.2d at 1345. At most, the testimony of its experts suggested that the Department should have adopted 3.5 percent or 4.5 percent as the terminal growth rate. *Id.* Even then, as the district court found, these rates suffered from the same alleged infirmities as the rate of 6.3 percent chosen by Dickerson, including that the rates would require expenses to become negative. *Id.* Based on this record, the district court did not clearly err.

IV. CONCLUSION

The judgment of the district court is

AFFIRMED.

FAY, *Circuit Judge*, concurring in part and dissenting in part:

As set forth in the majority opinion, the Railroad raises three issues in this appeal. The majority rejects all three of the Railroad's contentions. I agree that issues two and three have no merit. The district court did not err in finding Tegarden's appraisal was not based upon the same methodology as that used by the Board nor in accepting the 6.3 percent terminal growth rate used by the Board in its discounted cash flow evaluation.

Most respectfully, however, I disagree with the majority's holding that the 4-R Act bars the Railroad from challenging the valuation methodology chosen by the state. As acknowledged by the majority, our sister circuits have split on this issue. This gives me a little concern because in my opinion there is nothing ambiguous or complicated about these statutes.

Congress passed the Tax Injunction Act, 28 U.S.C. § 1341, which federal courts have enforced with great zeal. Congress, just as clearly, enacted the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), 49 U.S.C. § 11501, to correct a perceived evil; to wit: discriminatory tax practices by the states upon our national rail transportation system. The 4-R Act is a specific exception and excluded from the provisions of the Tax Injunction Act. 49 U.S.C. § 11501(c).

The language of the statute is straightforward and prohibits states from assessing rail transportation property at a value that has a higher ratio to the true market value than the ratio that the assessed value of other commercial and industrial property has to its true market value. If such a variation exists and exceeds five percent, relief may be granted to the railroad.

The only reference dealing with how such may be shown is a sentence that specifies that "the burden of proof in determining assessed value and true market value is governed by State law." 49 U.S.C. § 11501(c). It is apparent from the record in this case that there are many methodologies that can be used in assessing the value of property. No one has suggested that Georgia law approves of some and disapproves of others.[1] Surely a state could not use one method to assess

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[1] A quick glance at some Georgia cases shows that the method of appraising value is often in dispute. See *Rogers v. De Kalb County Bd. of Tax Assessors*, 247 Ga. 726, 279 S.E.2d 223 (Ga.1981), where the plaintiff sought an injunction prohibiting the Board of Tax Assessors from using the published market (i.e., "blue book") value to assess his aircraft and requiring them to value and assess the aircraft on the basis of original cost minus depreciation, the method more commonly employed to value business equipment, furniture and fixtures. The plaintiff argued that aircraft represented tangible property just as business equipment, furniture and fixtures did, and that Georgia law required uniform taxation of property within the same class. The Georgia Supreme Court held that: "it is not '[im]permissible under the uniformity of taxation provision of the constitution to apply different methods of arriving at the fair market value of tangible property.'" *Id.* at 728, 279 S.E.2d 223, (citing *Wade v. Ray*, 234 Ga. 234 (214 S.E.2d 923) (1975)). See also *Chilivis v. Backus*, 236 Ga. 88, 90 (222 S.E.2d 371) (1976), where the Supreme Court of Georgia reviewed a lower court ruling that prohibited the county tax assessor from considering any factor other than actual use in arriving at fair market value. Holding that actual use is a determinative, but not exclusive, factor for determining a property's fair market value, the Court observed that: "[t]he object of the assessors must be to determine the fair market value of the property subject to taxation in the county and the methods employed may be varied if the object is attained." See also *Colvard v. Ridley*, 218 Ga. 490, 128 S.E.2d 732 (1962), where the taxpayer alleged that the tax assessors had taxed their real and personal property according to different methods, violating the state mandate for uniform taxation within a given class of property. The Supreme Court of Georgia held that: "[w]hile tax assessors were permitted a wide range of tools of placing a value on property, they were required to use the same valuation tool when placing a value on property within one class." *Id.* at 491, 128 S.E.2d 732. Finally, see *Inland Container Corp. v. Paulding County Bd. of Tax Assessors*, 220 Ga.App. 878, 470 S.E.2d 702 (Ga.Ct.App.1996), where two corporate

the market value of railroad property and a different method to assess other commercial and industrial property if such resulted in gross discrimination toward the railroad.

As articulated by the Second Circuit, such a situation would be in direct conflict with the clear meaning of the statute:

> 4. Method of Appraisal
>
> Relying primarily on a decision by the fourth circuit in *Chesapeake Western Ry. v. Forst*, 938 F.2d 528 (4th Cir.1991), the SBEA contends that Conrail is bound by the method of appraisal that the SBEA has chosen, and that since it chose to use the cost approach, it is improper to consider any other method of valuation in fixing the "true market value" of Conrail's properties. The *Chesapeake* court viewed the method of appraisal as a matter of state policy that was beyond the reach of the 4-R Act. We do not accept that interpretation of the statute. What the 4-R Act prohibits is discrimination against railroads in the ratios of two sets of numbers: assessed values and true market values of the railroad's property vis a vis those of other commercial and industrial properties. To avoid the prohibited discrimination, the SBEA must apply the same valuation standards and methods to the railroad property as are used on the commercial and industrial properties to which it is compared. If the Act were to be interpreted, as defendants would have it, so that the SBEA could adopt a special appraisal method for railroads alone, then

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landowners challenged their property tax assessments, arguing that the assessors should have considered "existing use" of the property. Noting that it could only judge the sufficiency of the evidence, not its weight, the Georgia Court of Appeals cautioned, "[n]or may we accept or reject any opposing methods of appraisal presented at trial." *Id.* at 881, 470 S.E.2d 702.

> the whole nondiscrimination objective of the statute could be circumvented.

Consolidated Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 481-82 (2nd Cir.1995).

Since the objective of any methodology is a determination of *true market value,* a railroad should be allowed to challenge the method used in an attempt to prove that the result of such a method was not the *true market value* of its property. In sum, I agree with Justice Stevens that "the text of (the statute) . . . and its evident purposes convince me that Congress intended to bar discrimination by any means . . ." *ACF Industries*, 510 U.S. at 350, 114 S.Ct. at 853 (Stevens, J., dissenting). If the Railroad can prove that the method used by the state does not result in a fair appraisal of true market value and that the assessed value is in fact at a ratio higher than five percent of the ratio of true market value and assessed value of other commercial and industrial property, it is entitled to relief.

Having said all of this, I have no idea whether in this case the Railroad can meet its burden of proof. Although the district court found the Railroad's expert well qualified, other comments raise serious concerns about the weight that would have been given to the opinions expressed. I simply disagree with the absolute preclusion of any challenge to the methodology used by the state in arriving at the true market value of the Railroad's property.